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No. 640

Supreme Court, U.S.
FILED
SEP 22 1967
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In the Supreme Court of the United States

OCTOBER TERM 1967

PORTLAND CEMENT COMPANY OF UTAH,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE TENTH CIRCUIT COURT OF APPEALS

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PREVIOUS OPINIONS

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(11-25-64) 338 F2d 798, 64-2 USTC 9869
(third appeal)

Portland Cement Co. of Utah, v. U. S.
(4-29-66) 66-1 USTC 9430
(fourth trial)

U.S. v. Portland Cement Co. of Utah, 10 CCA
(5-16-67 F2d ...., ... USTC ....

These opinions are printed in full in the Appendix hereto. (See index).

JURISDICTION

The fourth opinion of the Tenth Circuit Court of Appeals in this matter No. 8886, was filed May 16, 1967—no time stated. The letter from the Clerk of the Tenth Circuit Court of Appeals notifying counsel for the taxpayer of the denial of its Petition for Rehearing was dated June 26, 1967.

Certiorari jurisdiction is conferred upon this Court by 28 USC 1254 (1).

QUESTIONS PRESENTED

I. The Tenth Circuit Court opinion has improperly ignored and overridden the opinion of this Court in *Cannelton*: first, in approving the proportionate-profits formula; and second, in disapproving the substitute materials method of computing the depletion base under the facts of this case.

(A) The proportionate-profits formula violates the principles laid down in *Cannelton* in every aspect of its application in this case.

(B) Existing case law fails to validate the proportionate-profits formula.

(C) The substitute materials-replacement cost method meets the requirements of *Cannelton* and the depletion statute involved.

(D) This taxpayer has been prejudiced by the application to it of the proportionate-profits formula instead of the use of a method designed to obtain fair market value.

II. The Tenth Circuit Court opinion has violated the Fifth Amendment in denying this taxpayer due process of law: first, in denying a hearing on the novel proposition of law which was the basis of the opinion; and second, in failing to give equal treatment under the depletion statute involved.

STATUTES AND REGULATIONS INVOLVED

Amendment V—due process of law.

26 USC 611(a) and 613—percentage depletion.

Treasury Regulations 118, Section 39.23(m)-1(e)(3).

These are printed in full in the Appendix hereto. (See index).

STATEMENT OF THE CASE

Original jurisdiction and critical statutes

This action was commenced in Federal District Court for the Central District of Utah for income tax refunds for the years 1954, 1955, and 1956. Jurisdiction was conferred by 28 USC 1331, 1340 and 1346(1). The critical parts of the IRC 1954 which had to be interpreted and applied were:

> Sec. 611 (a) " . . . there shall be allowed as a deduction . . . a reasonable allowance for depletion . . . according to the peculiar conditions in each case . . . "
>
> Sec. 613 (a) "In the case of mines . . . listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b) of the gross income from the property . . . "
>
> Sec. 613 (b) "The mines . . . and the percentages, referred to in subsection (a) are as follows: . . . (6) 15% . . . calcium carbonates . . . limestone . . . "
>
> Sec. 613 (c) "For the purposes of this section

(1) . . . The term 'gross income from the property' means, in the case of a property other than an oil or gas well, the gross income from mining.

(2) . . . The term 'mining' includes not merely the extraction of the . . . minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable product or products, and so much of the transportation of . . . minerals (whether or not by common carrier) from the point of extraction . . . to the plants . . . in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles . . . "

Fact Situation

This taxpayer mined "cement rock," an argillaceous (clayey) limestone—entitled to the 15% depletion rate as a calcium carbonate (as decided by the first Circuit Court opinion)—which is not suitable for any other purpose—not even for road building uses—than processing into cement. There is not a product which taxpayer produced or which it might have produced from its cement rock, which was or is marketable anywhere prior to its sale as bulk cement. No mineral of like kind and grade has ever been sold anywhere, except as finished cement. (Findings of Fact, 8, 9, 13—App. 49, 50.) Only 25% of the cement produced in the U.S. in 1956 was made from cement rock; the other 75% was variously made from limestone and clay or shale, marl and clay, slag or iron ore and limestone, or oyster shells and clay (Exhibit 3, App. 31).

The four necessary ingredients of cement—calcium carbonate, silica, alumina and iron—are all found in cement rock, and in such proportions that little or no additional materials are necessary for the production of cement meeting ASTM specifications—and are found in such a state of intimate association that lower power consumption in grinding and lower fuel consumption in sintering are required than when other materials are used (App. 12, 21).

The facts of this case squarely presented both of the basic problems of percentage depletion for the first time in any court: First, what is the proper cut-off point to "mining"; and Second, how should the mineral product be valued at that point in the absence of any actual market or representative field price?

Congress tried to solve the second problem by tying the cut-off point to a "commercially marketable product"—interpreted by the courts as "the first commercially marketable product" which was or could be obtained from the deposit in question—the market price of which product would automatically set a value on the product, thus solving the second problem. The total market value on an f.o.b. mine basis, of the "first commercially marketable product obtainable from the mineral product sold during a year was the statutory depletion base—the yardstick by which the value of the raw mineral extracted and consumed was to be measured —to which the applicable percentage rate was applied to determine the allowance for the value of the capital assets consumed and depleted. This method of determining the depletion base reflected the value of the deposit as affected by its location with respect to con-

sumers, and gave a representative field price by which to measure the value of the product of those "integrated miner-manufacturers" which do not sell on the first available market.

First Trial

The first "cement rock" case under this statute had been *Dragon Cement Company v. U.S.*, 224 F2d 513 (1 CCA 1957), cert. denied 355 U.S. 833, which held that the cut-off point for cement rock mining was at the bulk cement stage, prior to any bagging. At the first trial of this case the District Court followed the *Dragon* rule—and the government appealed.

First appeal

Before the first hearing in the Tenth Circuit Court this Court handed down its opinion in *U.S. v. Cannelton Sewer Pipe Co.*, 364 U.S. 76. The Circuit Court remanded this case, instructing the District Court to determine whether or not its original judgment should be altered in the light of *Cannelton*.

Cannelton

The essential facts before this Court in *Cannelton* had been these: In Cannelton's market area (Indiana-Kentucky) there were a number of clay miners, falling into two categories: First, operators which engaged primarily in strip mining of coal, and which, during their coal mining operations, stripped bare "underclay" which they sold as a by-product; and Second. those operators who mined "underclay" laid bare by

previous mining operations. (*Cannelton Sewer Pipe Company v. U.S.*, (7 CCA) 268 F2d 334, 336.) This clay which they sold was without grinding or crushing or other non-extractive processes—characterized by this Court as "raw" and "crude". The clay was merely extracted, loaded and shipped to buyers. Cannelton, however, extracted clay from its underground mine at costs higher than the prices at which it could have purchased clay of like kind and grade in the surrounding market area (364 U.S. 76, 78-80), shipped the raw clay to its plant where it produced fabricated products, including fire brick, tile and sewer pipe.

Cannelton was making more money on the tax savings resulting from its depletion "gimmick" than it lost on its uneconomic mining operation, because it was using the sale prices of its finished products as its depletion base. (Subsequently, Cannelton began securing its clay from a leased strip mine and abandoned the "gimmick" (364 U.S. 76, 80-81)). In this fact situation this Court saw a tax loophole of potentially large proportions. The acquisition and use of an uneconomic (high mining cost) mineral deposit—otherwise unnecessary to the main operation because similar raw material could be purchased cheaper on the local market—would allow a taxpayer to take an unfair depletion allowance for a mineral actually having no economic value in the marketplace.

This Court closed the loophole, saying (364 U.S. U.S. 76, 89):

> "In view of the finding that substantial quantites—in fact, the majority—of the tonnage production of fire clay and shale were sold in this

> raw stage, we believe the respondent's mining activity during the year in question would come under clause (iii) of the section here involved. That clause includes 'minerals which are customarily sold in the form of a crude mineral product.' We believe that Congress intended integrated mining-manufacturing operations to be treated as if the operator were selling the mineral mined to himself for fabrication.'

The cut-off point to mining was set at the point at which the crude clay was ready for shipment from the mine to the plant, at which point there was a representative field price set by competition in the local market for mineral products of like kind and grade. This Court expressly distinguished *Cannelton* from percentage depletion cases cited by respondent (which included *Dragon*) on the facts, but stated that this was no indication of any approval of holdings of those other cases (364 U.S. 76, 89).

Second trial

The District Court saw no market whatever for "cement rock," which has never been sold crude; and in its second opinion held that *Cannelton* had no application here in determining the cut-off point. The government appealed for the second time.

Monolith

After the second hearing before the Tenth Circuit Court, but before its opinion had been published, this Court's decision in *Riddell v. Monolith Portland Cement Company*, 371 U.S. 76, was handed down per curiam—without a hearing. The essential facts before this Court

in *Monolith* were these: Monolith mined limestone, crushed it, transported it two miles to its plant, mixed it with other materials (containing the necessary silica, alumina and iron), and made cement. Crushed limestone not used in the making of cement was sold in California (1,500,000 tons in 1952) and elsewhere (total 1952 tonnage—216,000,000), as indicated in footnote 2 to this Court's opinion. This Court held that *Cannelton* was controlling, saying that "mining" should be cut-off "at the point where the mineral first became suitable for industrial use or consumption." (371 U.S. 76, 77). As in *Cannelton*, there was a representative field price of mineral products of like kind and grade to Monolith's at the cut-off point as "crushed limestone."

Second appeal

Noting the language of this Court in *Cannelton* and *Monolith*, the Tenth Circuit Court in its second opinion herein, said that this taxpayer's rock was shippable and was suitable for industrial use as crushed cement rock; and further held that this taxpayer should be treated as having sold its cement rock to itself at that point — ignoring the qualification made by this Court in both *Canelton* and *Monolith* that the depletion base was the constructive income from the raw mineral product *if marketable in that form*—which cement rock is *not*. This taxpayer's mineral product is not, has never been, and cannot be sold prior to the bulk cement stage. There is no representative field price for products of like kind and grade (Finding 13, App. 50) by which to set a value on taxpayer's rock at the cut-off point set by the Tenth Circuit Court.

This presented a problem never before considered by the courts under the statute applicable here—and the Circuit Court did not attempt to attack this problem in its second opinion herein. Nor did that opinion make entirely clear what cut-off point was intended—whether at the quarry after primary crushing, or after the completion of crushing at the plant 12 miles away in downtown Salt Lake City. (Most producers combine primary and secondary crushing into one closed-circuit operation, but this was not done here because of a lack of space at the quarry in the narrow Parley's Canyon area.) Rehearing was denied.

Third trial

The District Court at the third trial held that the cut-off point was after all crushing had been completed, and that the proper method of arriving at the "constructive gross income from mining" was the "proportionate profits" formula set out in Treasury Regulations 118 Sec. 39.28(m)-1(e)(3). The government appealed the first holding as to the cut-off point; this taxpayer appealed the second holding relating to the "proportionate profits" formula.

Third appeal

The Tenth Circuit Court, in its third opinion herein, reversed on both issues, holding as to the first:

> "We conclude that *Cannelton* and *Riddell (Monolith)* require the holding that mining terminates at the end of primary crushing. This means that the depletion allowance applies to the value of the product at that cut-off point."

As to the second holding:

> " . . . In the circumstances the courts should determine the proper method of ariving at constructive value.
>
> The trial court's rejection of the evidence offered by the taxpayer precluded the taxpayer from presenting its contentions that the proporionate profits method is unfair and that another method more clearly reflects its gross income from mining. In our opinion the evidence should be received. On retrial the court should determine the validity of the proportionate profits method and, if it is held invalid, the method which should be applied to fix the depletion base."

Fourth trial

At the outset of the fourth trial, government counsel and the District Court agreed (App. 80) without dissent by this taxpayer, that the cut-off point intended by the Circuit Court was the chute by which the crushed rock was loaded into trucks for shipment from the quary to the plant. Then the District Court set out to find the *value* of taxpayer's product at that point in its operations, in accordance with the instruction of the Circuit Court.

The District Court finally adopted a method proposed by the taxpayer, which was a "substitute materials" variation of the "replacement cost" method widely used by accountants and approved by Treasury Regulation 118-39.22 (c)-4 for the valuation of inventories. The District Court found that "this method conforms to good accounting practice and to the proposed (but as yet unadopted) Treasury Regulation Par. 1.613-3(b) (4) (1)" (which was withdrawn prior to the

fourth appeal herein), " . . . which is a modification of the representative field price method, suitable to the computation of 'constructive' gross income from mining" (Finding 18, App. 51).

Replacement by actual reproduction of the cement rock through artificial means was not physically possible, let alone economically feasible. However, replacement in *function* of the cement rock by substitute materials which could satisfactorily be used to obtain a suitable mix to feed the kilns, was possible. Substitute materials, though quite limited as to range of chemical composition, were available in sufficient volume to replace in function this taxpayer's cement rock. A combination—in proportions mathematically determined by the ATSM specifications and the chemical analysis of the respective materials—of chemical grade limestone, high alumina clay, and iron ore or slag, was found suitable and available (Finding 17, App. 51). This was what a potential competitor newly coming into the area would have had to do, as no other single quarry deposit suitable as a cement mix was available within a 75 mile radius of Salt Lake City (Finding 14, App. 50). In fact, from information elicited from various parts of the nation through depositions taken in this matter, it was established that all but approximately twenty cement producers in the United States actually made cement by securing such raw materials from several different sources.

The cost of acquiring equivalent tonnages of substitute materials laid in at the plant, adjusted to eliminate the cost of transporting the taxpayer's own rock from quarry to plant, was used as the basis for deter-

mining the value of taxpayer's mineral product as it was loaded into trucks for shipment. This basis was further adjusted to allow for altered handling and processing costs which would result from the use of the substitute materials (such as higher fuel costs during sintering) (App. 72-74). Under the Circuit Court's instruction that taxpayer was to be treated as having sold its mineral product to itself at the loading chute cut-off point, the total value of the taxpayer's cement rock produced and shipped during each of the years in question was used as the depletion base—"gross income from mining" — for those years (Finding 20, App. 52).

(Rather than using the tonnage produced and shipped to its plant each year, taxpayer might conceivably have used the tonnage consumed in the production of cement sold in each year. This would have resulted in a higher depletion base, since the beginning cement inventory in 1954 was $25,139.92 greater than the ending cement inventory in 1956 (Exhibit A, Schedule 1-A, App. 325)—no crushed rock inventory having been maintained—showing that more rock was sold in cement form than was produced during those years, and would have had the further effect of pushing back the beginning of taxpayer's depletion period to include rock shipped to the plant in 1953. To simplify the computations and eliminate another potential issue from the case, the taxpayer (and the District Court) followed the literal instruction of the Circuit Court with no objection from the government.)

The District Court found that this method of determining its gross income from mining more accu-

rately and fairly reflected the value of its mineral product at the cut-off point than did any other method suggested (Finding 18, App. 51).

The government's proportionate profits formula, rejected by the District Court, is embodied in Treasury Regulations 118 (1939 Code), Sec. 39.23(b)-1(e)(3):

> " . . . If there is no such representaive market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes . . . "

There has been no argument by the government, nor any question by the Circuit Court, that the District Court did not thoroughly understand the mechanics of the government's method, as developed from a dialogue between the District Court and the government expert accounting witness, and embodied in Finding 19 (App. 51). That method is most clearly stated in terms of the facts of this case by the following formula:

book costs of "mining" (costs of extraction plus costs of primary crushing)

÷

book costs of "mining" plus book costs of "manufacturing" (post cut-off processing costs)

X

gross receipts from the sale of finished cement (bulk, not including bags or bagging costs)

=

depletion base (gross receipts from "mining").

The District Court found that this taxpayer's *book costs* of mining and processing bear no necessary relationship to the *value* of its mineral depleted, that the ratio of book costs does not reflect in the slightest degree the value of this taxpayer's mineral, and that the application of this ratio to gross receipts gives a result which does not reflect the value of this taxpayer's cement rock after primary crushing. Further, the government formula apportions the book net profit equally among the dollars of cost as though earned by them, without attributing one cent of gross receipts to the cement rock depleted and used, and results in a depletion allowance grossly inadequate to permit the tax-free recovery of the capital value of this taxpayer's mineral used and depleted (Finding 19, App. 51).

The District Court concluded and held that the government formula was not applicable, and that the taxpayer's method was satisfactory and proper in computing this taxpayer's "constructive gross income from mining." (Conclusions 1-2, App. 52). The government appealed the fourth time.

Fourth appeal

The fourth Tenth Circuit opinion herein did not upset the District Court findings of fact, but reversed the conclusions, holding that the government's proportionate profits method results in a reasonable depletion allowance and that the taxpayer's substitute materials method does not reflect the gross income from the property under the facts of this case. Rehearing was denied. From this decision the taxpayer now seeks certiorari.

ARGUMENT

I.

THE TENTH CIRCUIT COURT OPINION HAS IMPROPERLY IGNORED AND OVERRIDDEN THE OPINION OF THIS COURT IN *CANNELTON*: FIRST, IN APPROVING THE PROPORTIONATE PROFITS FORMULA; AND, SECOND, IN DISAPPROVING THE SUBSTITUTE MATERIALS METHOD OF COMPUTING THE DEPLETION BASE UNDER THE FACTS OF THIS CASE.

(A) The proportionate profits formula violates the principles laid down in Cannelton in every aspect of its application in this case.

This Court in *Cannelton* gave a detailed analysis of the history and purpose of percentage depletion law, and laid down its basic principles. This has been totally ignored in the fourth Circuit Court opinion herein, with the only reference to *Cannelton* in the entire opinion being an off-handed remark in footnote 11. Principles applicable to this case, as referred to in the *Cannelton* situation, were stated by this Court (376 U.S. 76):

> " . . . under the mandate of the statute, respondent's 'gross income from mining' under the findings here is the *value* of its raw fire clay and shale, after the application of the ordinary treatment processes . . . "
>
> "Depletion, as we have said, is an allowance for the exhaustion of capital assets. It is not a subsidy to manufacturers or the high cost mine operator. The value of respondent's vitrified clay products, obtained by expensive manufac-

turing processes, bears little relation to the *value* of its minerals. The question in depletion is what allowance is necessary to permit the tax-free recovery of the capital value of the minerals."

" . . . respondent's problem is one purely of cost of recovery, an item which, as we have said, has nothing to do with *value* in the depletion formula. Depletion, as we read the legislative history, was designed not to recompense for costs of recovery but for exhaustion of mineral assets alone."

Here, as in *Cannelton,* this taxpayer's costs of extraction and crushing, and its manufacturing costs as well, bear little or no relation to the value of its mineral in the depletion formula—no more than did Cannelton's cost of recovery. The numerator of the ratio of costs used in the proportionate profits formula here, is book costs of extraction and primary crushing —which have nothing to do with the value of its minerals. The denominator of that ratio consists of this "costs of mining", plus "costs of manufacturing." Here as in *Cannelton,* the costs of taxpayer's expensive manufacturing processes have nothing to do with the value of its minerals. Here, as in *Cannelton,* the ratio of those book costs has nothing to do with the value of its mineral—and has nothing to do with *value* in the depletion formula.

The District Court found that the fair market value of a ton of this taxpayer's cement rock at cut-off was $3.70. The sale price of the cement in bulk, made from a ton of that rock, was $13.33. The value of this taxpayer's finished cement, obtained by expensive manufacturing processes, bears a closer relation

to the value of its mineral than was the case in *Cannelton*. But the relation was not close enough for the Tenth Circuit Court in its second opinion to let that value of finished cement stand as the depletion base—the yardstick by which the value of the cement rock depleted was to be measured. If that opinion was correct in setting the cut-off to "mining" prior to the first point at which the mineral product was or could be marketed anywhere, then the value of this taxpayer's finished cement has *not* sufficient relation to the value of its mineral to justify admission of that finished cement value to a place in the depletion formula.

Every element of the proportionate profits formula set out above, was found by this Court in *Cannelton* to bear little or no relation to the value of the minerals depleted. The same is true here, with the possible exception that the Circuit Court erred in setting the cut-off point prior to finished cement.

Here, as in *Cannelton*, under the mandate of the statute, this taxpayer's "gross income from mining" under the findings is the value at the cut-off point, of its cement rock which was subsequently used and consumed in manufacturing. The application of the proportionate profits formula results in a "gross income from mining" figure having absolutely no necessary relationship to the value of its cement rock at cut-off, and which, under the findings, is much lower than the actual value of the cement rock at cut-off. The value of one ton of taxpayer's crushed cement rock at cut-off was found to be $3.70 for each of the years in question. The prices of the substitute materials had not changed, nor had the prices of finished cement, *nor had the per*

ton value of taxpayer's mineral product at cut-off changed. But the arbitrary price per ton set by the proportionate profits formula had changed — from $1.89 in 1954, to $1.61 in 1955, to $1.51 in 1956—being 25% higher in 1954 than in 1956. Thus, the gross income from mining figure set by the proportionate profits formula varied in proportion to mining and manufacturing costs having little or no relationship to the value of taxpayer's mineral at cut-off. The tonnage produced and shipped in 1956 was 16,569 tons greater than in 1954, and with the customary increases in efficiency that go with increased volume, the per ton cost of mining decreased—which, under the proportionate profits formula, reduced the aribitrary price per ton at cut-off, although the actual value per ton remained constant. This taxpayer was actually penalized by a decreased depletion allowance for the increased efficiency of its mining operation. *Cannelton* requires that this taxpayer's gross income from mining reflect the steady value of its mineral. Conversely, increased costs of extraction do not increase the value of the mineral product as would result from the proportionate profits formula. Even the government recognized this fact (since abandoned) when it wrote its original brief in the *Cannelton* case in 1959, when it stated on page 84:

> " . . . A mine does not become more valuable because the costs of operation are high or because its stratetgic market location is poor."

Approval of the proportionate profits formula reopens the subsidy loophole closed by this Court in *Cannelton.* Two simplified examples will illustrate this point:

Suppose a cement producer sells 100,000 barrels of cement at $4,00 per barrel—a price set by competition in the local market. Assume further, that its book costs are $75,000.00 up to cut-off, and its book manufacturing costs are $125,000.00. The proportionate profits formula determines gross income from mining as—

$$\frac{\$75,000.00}{\$75,000.00 + \$125,000.00} \times \$400,000.00 = \$150,000.00$$

The depletion allowance then is $150,000.00 X 15% = $22,500.00.

Now assume the same taxpayer has an identical year, except that due to replacement of its old kilns and finish grind mills by expensive new automated equipment and the application of the accelerated depreciation provisions of the IRC, the book manufacturing costs increase $100,000.00. Ultimately, the operator hopes to recoup this outlay through greater efficiency and increased production. This year, the proportionate profits formula is—

$$\frac{\$75,000.00}{\$75,000.00 + \$225,000.00} \times \$400,000.00 = \$100,000.00$$

The depletion allowance becomes $100,000.00 X 15% = $15,000.00

The gross income from mining has decreased from $150,000.00 to $100,000.00 due solely to increased manufacturing costs—and despite the fact that the actual value at cut-off of the mineral product consumed has *remained the same!*

Let us now assume that this same taxpayer has

an identical year to the first, except that due to less efficient mining operations difficult to pinpoint and assess (such as a labor slowdown, less efficient motor operations, etc.) its book costs of mining increase $100,000.00. This year, the proportionate profits formula is—

$$\frac{\$175,000.00}{\$175,000.00 + \$125,000.00} \times \$400,000.00 = \$233,000.00$$

The depletion alowance becomes $233,000.00 X 15% = $35,000.00.

The gross income from mining has increased from $150,000.00 to $233,000.00 *due solely to increased mining costs*—and despite the fact that the actual value at cut-off of the mineral product consumed *has remained the same.*

Comparing years two and three, we see that the total profits before depletion allowance is the same for both years—$100,000. The proportionate profits formula has allocated $25,000 to mining and $75,000 to manufacturing for year number two, and has allocated $58,000 to mining and $42,000 to manufacturing for year number three. We see that, according to the government formula, the less efficient mining operation has "earned" over twice as much profit, and the resultant depletion allowance is over twice as large, although the actual value at cut-off of the mineral product consumed *was the same.* Again referring to the position taken by the government in the *Cannelton* case (since abandoned), at page 23 of its brief it recognizes the ultimate result:

> "The view adopted below rewards the manufacturer who acquires an inefficient mine, . . . It gives rise to what might be termed a Gresham's law of depletion: bad producers drive out good."

The differences in these illustrations are greater in magnitude than would occur in practice under a quarry cut-off point. But when the cut-off point is moved to the kiln-feed stage, as was done by the 1960 amendment to Section 613, the pre- and post- cut-off costs much more nearly approach a balance, and this exaggeration of the differences is not so great—and this whole issue of the validity of the proportionate profits formula becomes extremely critical. The Tenth Circuit Court's fourth opinion, plus the new statute, has opened up the same subsidy loophole that this Court closed with *Cannelton*, except that the loophole is now larger than ever.

The new statute, in setting different cut-off points to mining for miners of identical deposits—one of which sells to a cement producer as crushed rock, and the other of which is a cement producer and gets a kiln-feed cut-off—is open to the objection of unconstitutionality. But from a practical standpoint, who is going to make such a challenge? Certainly not the big cement producers with multiple deposits of comparatively low value minerals, who are responsible for the very large majority of the cement produced and who benefit from the fictitious prices resulting from the use of the proportionate profits formula under the new statute. Cement slurry at the kiln-feed cut-off point has no market and cannot be marketed thus invoking the proportionate profits formula—accordingly, such large producers

benefit from the government formula since they do not have to base their depletion allowances on real values. If the Tenth Circuit Court's fourth opinion is allowed to stand, any small producer with a high value mineral product is practically precluded from attacking the government formula and the constitutionality of the new statute, since it can hardly be imagined that a better fact situation exists anywhere than in this case and the rationale of such an attack would have to be similar to the one here advanced.

It is certainly a fact, as was illustrated in *Cannelton,* that many raw material miners have minerals of such low actual value that their main concern is to recover their costs of production which are very high in relationship to the actual value of the mineral being used. It is obvious that they would prefer to have percentage depletion based upon the proportionate profits formula, since it gives them an actual subsidy. On the other hand, a miner which has a valuable mineral—competing in function with the law-value mineral —and whose costs of mining are low relative to the value of the mineral used, is hurt by the formula.

This Court in *Cannelton* indicated that the Shepherd Report recommendation that the depletion base should be "the competitive market receipts, or its equivalent, received from the sale of the crude products of an f.o.b. mine" basis, was incorporated into the 1932 and subsequent acts. The proportionate profits formula —and the Circuit Court's fourth opinion—ignore any consideration of competitive market receipts from sales of the crude product, and determine the depletion base by adding to book costs of mining an arbitrary "profit"

fixed by a cost proportion utterly unrelated to the value of the mineral depleted. "Competitive price making is not a process of finding cost and adding a reasonable margin" (Dr. W. A. Paton, *Shirtsleeve Economics* (1952), p. 185); much less is it a process of finding book dollar costs of mining (which do not include the real *economic* cost of the rock-in-place value depleted) and adding an unreasonable and arbitrary so-called "profit margin".

The proportionate profits formula (see Finding 19—App. 51) apportions book profit before depletion, computed under Treasury Regulations which exclude any consideration of the economic costs of the depletion of the rock-in-place value. This is not directly deductible; the depletion allowance authorized by Section 611 is supposed to take care of this item. The proportionate profits formula, therefore, apportions equally among all the book dollar costs of production, *as a profit earned in equal amount by each of those costs,* that portion of the book profit before depletion which in fact represents the return of the capital value of the rock depleted. This all belongs to *rock consumed*—not to costs of labor, equipment, fuel, power, etc.

The proportionate profits formula assumes the validity of the "labor theory of value," wherein the sole source of value is the labor cost of production (whether direct or in the form of depreciation on the "congealed labor cost" of machinery and equipment and the "congealed labor cost" of materials used)—denying any contribution to the value of any product by the natural (unworked) raw materials utilized therein, or by the invested capital of the owners of the business making

the product — holding any "profit" to be in fact a squeezing or theft from labor (direct or "congealed") which should properly be assigned to such labor rather than to natural raw materials or capital investment. This theory is straight from Karl Marx—and is subject to the same basic criticisms; i.e., that every labor hour is *not* exactly as productive of ultimate revenue as every other labor hour, that natural raw materials *do* contribute to value, that invested capital *does* contribute to value, and that non-production costs such as distribution and selling costs contribute to value, as well.

Any "profit" figure determined without consideration of the value of natural raw materials depleted is not a true figure, but is false and misleading (Paton and Paton, *Asset Accounting* (1952) p. 443):

> "Depletion is clearly an actual cost of production and must be taken into consideration if true net income or loss is to be disclosed. . . . investors should not be encouraged to assume the contrary. Failure to recognize depletion amounts to the omission of the cost of raw materials—a procedure which would be unthinkable in manufacturing and which cannot be condoned in the field of extraction."

The proportionate profits formula apportions the bulk of the actual depletion cost (included in its false "profit" figure) to manufacturing costs *as a profit earned by those costs,* when in fact all of the actual depletion cost is a real cost of mining.

The government argues that its formula results in a figure which *is* assigned to mining as a depletion allowance, albeit *not* within the formula by means of

which its allowance is computed. But this allowance, so arbitrarily computed in complete disregard of the economic facts of life, bears no necessary relationship to the actual depletion cost (rock-in-place value consumed) and may be either greater—effecting a subsidy—or less than that amount, depending upon the particular taxpayer's circumstances. In the latter situation the taxpayer's assets do not remain unimpaired, they are seized and confiscated by the Director of Internal Revenue. This result flouts the purpose of percentage depletion as stated by this Court.

It would only be by sheer happenstance that a determination of "gross income from mining" by application of the proportionate profits formula might ever equal the actual value of a mineral product at cut-off. The formula is purely arbitrary and contrary to the principles set out in *Cannelton*. *Cannelton*—and justice require that the depletion base be fixed by a reasonable attempt to ascertain the fair market value at cut-off of the taxpayer's mineral product produced, shipped and consumed—that is to say, the nearest equivalent as it is practicable to obtain, of "the competitive market receipts" received from the sale of the crude products"—not by the application of an arbitrary formula that disregards any consideration of possible equivalents to "competitive market receipts from the sale of the crude product."

Only if it embodies some reasonable and consistent relationship between the depletion base—however determined—and the purpose of depletion, can any formula for determining the depletion base be anything but arbitrary. But Section 611 (a) of the I.R.C.

1954 requires that the allowance be "reasonable . . . according to the peculiar conditions in each case." The allowance reached by the proportionate profits method is not reasonable—it is entirely unconnected with the fair market value at cut-off of the mineral product shipped and consumed, or with the value of the capital asset consumed, and is contray to the principles stated in *Cannelton.*

The only reference to *Cannelton* in the Circuit Court's fourth opinion is found in footnote 11. In that footnote is the following statement:

> "We realize that in *United States v. Cannelton Sewer Pipe Co.,* 364 U.S. 76, 86, and in our third decision in this case, 338 F. 2d 798, 802, reference is made to 'value' of the product. This loose use of the term 'value' cannot change the statute."

The Tenth Circuit Court does not explain what this Court meant when it repeatedly used the word "value" in connection with the purpose of depletion and the depletion base, or explain this Court's repeated repudiation of "costs" in that connection. Nowhere does the Circuit Court attempt to show what this Court might have intended if its *Cannelton* opinion is not to be taken on its face, as it reads. In a depletion case, when used in connection with the determination of a dollar depletion allowance, a dollar "gross receipts from mining" amount, what possible meaning can "value" have but "exchange value" or "selling price"? Certainly not "utility", or any subjective meaning "value" might possibly have in another context. The word "value" has no "loose meaning" in the *Cannelton* opinion nor in day to day economic usage.

The Circuit Court seems to have been mislead by the government's confused economic theory into an error which is at the heart of its fourth opinion. Contrary to its instruction to the District Court in its third opinion herein:

> "'. . . mining terminates at the end of primary crushing. This means that the depletion allowance applies to the value of the product at that cut-off point. . . . In the circumstances the courts should determine the proper method of arriving at constructive value."

The fourth opinion reads:

> "We decline to equate the value of product with gross income from mining in the circumstances here presented."

It is uniformly agreed today—even by Marxists—that the price a product brings when sold on a free market, having willing and informed buyers and sellers, is the value of that product at the time of sale. The total price any taxpayer's production brings when sold is that taxpayer's gross income from its product—which is the value of that taxpayer's production sold during the period. The total price received for this taxpayer's cement sold is this taxpayer's gross income from cement; likewise, the total fair market price of this taxpayer's crushed cement rock at termination of mining is this taxpayer's gross income from mining. The total fair market price of this taxpayer's cement rock at cut-off is the *value* of that product at cut-off. The fact that such fair market price of this taxpayer's product at cut-off must be computed in the absence of cement rock sales at that point, by sales of substitute

materials available at that point, is the result of the Circuit Court's second opinion herein extending *Cannelton* beyond its facts. This taxpayer should not be penalized by being forced to accept, as a miner, from itself as a purchaser-manufacturer, a price for its mineral product which is arbitrary and far below fair market price. Only two taxpayers, both of which settled out of court after the second Tenth Circuit Court's opinion herein, have been caught in a similar fact situation under the statute applicable here—as far as appear in the cases—and all others have had as a depletion base the actual market price of their production. This includes producers of calcium carbonate and limestone for all purposes, including the makers of cement therefrom. What "circumstances here presented" justify such a statement as made by the Circuit Court in its fourth opinion have not been explained. It can only be concluded that that Court was unable to comprehend the basics of accounting and economics, refused to be informed therein, had a misunderstanding of the facts, and made a mistake in underrating this Court's understanding and precision of language in *Cannelton*.

(B) Existing case law fails to validate the proportionate-profits formula.

The Circuit Court opinion does not attempt to explain how or why the proportionate profits formula can be considered "reasonable", rather than arbitrary. It has relied solely on "authority"—but it has ignored *Cannelton*, saying:

> "Here we are concerned with a regulation of more than 25 years standing. It has been be-

fore the Courts a number of times without question of its underlying validity being raised."

This regulation is really not "of more than 25 years standing." It has been on the books for that time, but was inoperative until 1961. The proportionate profits formula applies only where there is no market or representative field price. Until the new statute of 1960, the cut-off point to mining was the "first commercially marketable product." Until the Court's ruling in the second appeal of this case in 1962, no court had ever interpreted "first commercially marketable product" in such a way as to set a cut-off point where there was not at least a representative field price to fix the depletion base. The new statute brought the formula into use in 1961, but on a vastly different cut-off point than this Court set in its third opinion, raising quite different problems and inequities. The formula has been in active operation for only six years, not 25. It has been applied under the statute before this Court only twice to taxpayer's knowledge, to this taxpayer and to a producer from cement rock which settled out of court after the Court's second opinion in this case. The "number of times" the formula has been before the courts have been under the new statute with kiln feed cut-off. All but one of these cases have involved miners of other than cement rock, and none challenged the underlying validity of the formula. Whether this was because of uninformed counsel or because they stood to benefit rather than lose by the application of the formula (as many do), or both, this is no support to the formula when challenged on principle. There are a few cases, some prior to 1961, in which the courts have held the

formula inapplicable where its use was advocated by the taxpayer, always because there was a market or representative field price.

The single cement rock case, *Whitehall,* is cited by the Circuit Court in support of its position, saying:

> "The argument that the proportionate profits method is unfair because it does not take into account the value of the deposit was rejected in *Whitehall* . . ."

but footnotes that statement with

> " . . . it (Whitehall) is not analogous to the situation before us . . . the taxpayer's alternative to the proportionate profits method was a formula whereby the gross income from cement was determined on the ratio of the weight of cement rock to the weight of all other ingredients. The gross income from mining was reached by application of the ratio of pre-kiln (cut-off point in Whitehall) costs with total direct costs to the gross income from cement rock."

The taxpayer in *Whitehall* did not argue that the proportionate profits formula as such was invalid or unfair—as footnoted by the Circuit Court, the taxpayer itself used the formula *in its own computation.* The taxpayer in *Whitehall* challenged the government method of determining what part of gross income from cement was in fact due to sales of cement made from cement rock and what part due to sales of cement made from purchased raw materials (which is not involved in the case before this Court). The *Whitehall* taxpayer's method of making this determination was on the sole basis of respective weights of materials used, which as this taxpayer has proved (Finding #16)

in this case is an arbitrary method. (No connection between weight of purchased materials and profits was established in *Whitehall*—in this taxpayer's case the purchased materials were found to cost more to process, so that no profits were due or allocable directly to them). That the *Whitehall* taxpayer's arbitrary method fell before the Commissioner's arbitrary method is proper. But the Court in *Whitehall* did not reject the argument that "the proportionate profits method is unfair because it does not take into account the value of the deposit" as made against the formula in toto by this taxpayer, because that was not done—the issue was not before the Court. The taxpayer in *Whitehall* argued that the government formula was satisfactory when modified by the prior allocation of gross receipts by weight, that if this arbitrary modification was not made it was unfair under the circumstances of the kiln-fed cut-off point. Unfairness under quarry cut-off is quite a different thing—as also a challenge to the fairness of the basic principle of the formula is quite a different thing from acceptance of the formula in principle with an arbitrary modification to which "value of the deposit" had no connection whatsoever. *Whitehall* is no support for the Circuit Court's opinion. That opinion cannot be supported by authority—there is none in support, only *Cannelton* in principle against it. This is a first case on the precise point at issue, which was raised herein at the earliest possible moment.

An examination of the court cases which have resulted from the new statute of 1960—which give a kiln feed cut-off point to miners engaged in making cement, at which point no one can sell the product, and

therefore brought into use for the first time the "proportionate profits" formula—shows that the government has been quite inconsistent and discriminatory in the manner in which it has applied its formula. In each court case the various costs involved were classified differently. This taxpayer would like the opportunity to analyze all of these cases in detail, and show this Court how arbitrary, discriminatory and unfair the administration of percentage depletion has been with the application of the proportionate profits formula. At this point taxpayer can only ask this Court to note that the government has won *all* of the court cases except the latest—against *California Portland Cement Co.*—which case is now pending before the Ninth Circuit Court.

This points up the fact that *once an arbitrary formula is accepted as satisfactory under the statute, it is invulnerable to attack since there is no appeal to reason and the presumption in favor of the government automatically prevails.*

(C) The substittue materials-replacement cost method meets the requirements of Cannelton and the depletion statute involved.

The fourth Circuit Court opinion herein states in regard to this method: "In our opinion, the statute does not permit such procedure." The procedure objected to was: first, the finding of the fair market value of a ton of taxpayer's mineral product at cut-off, by means of ascertaining the cost of replacing that ton, in its function as a suitable mix for cement making, with other substitute

materials available on the local market; and, second, the multiplying of that per ton value times the tonnage produced and shipped to the plant to obtain the figure used as gross income from mining; and, third, the multiplying of that value of tonnage produced and shipped figure by the 15% depletion rate (Finding 20—App. 25). Just what part of this procedure was objectionable to the Tenth Circuit Court was not made clear since it expressly held open the possibility that in other circumstances " . . . a constructive determination of gross income can be made by the use of the substitute materials method." Since the producers of over 75% of the cement made in this country actually acquire substitute materials of the same type, why should this method be denied this taxpayer in the absence of sales of its own mineral product?

There can be no reasonable objection to the taxpayer's method based on a quibble with words or labels; any objection must go to the substance of the taxpayer's method. The facts are clear—all rock produced each year was shipped, its value as it slid down the loading chute into the trucks was computed by multiplying the tonnage so loaded by the fair market value per ton. This figure was used as the gross income from mining under the proposition stated in the second Circuit Court opinion herein that this taxpayer must be treated as having sold its product to itself at that point. As noted above in the Statement of the Case, it might have been objected to by the government that the rock had not been actually sold at that point, and that the gross income from mining should be determined from the tonnage of rock consumed in the production of cement

actually sold during the years in question. This would have resulted in a larger depletion base, since the tonnage of rock necessary to the production of the cement actually sold during those years was greater than that produced—the cement inventory decreased—and the government did not so object. If this is the basis of the Circuit Court's objection, such is not clear from the opinion, and surely warrants only a return to the District Court for recomputation rather than disallowance of taxpayer's method in this case.

The objection of the Tenth Circuit Court seems to go to the question of value, and appears to be based on a belief that the depletion statute has set a depletion base—gross income from mining—which is *not* the value of the product at cut-off. It says:

> "The value of a product is not the measure of income therefrom."

But gross income from a product is the total selling price of that product, which is the value of the product at the time of sale. This is basic high school economics.

The Circuit Court stated:

> "The value of a product is not necessarily the same as gross income from the production of that product. For there to be income the product must be converted to money or its equivalent."

There has been a sale of all of the cement made from the crushed rock—all of which was shipped to the plant and used for that purpose—and cash received therefrom. Has not the rock been converted to "money or its equivalent"? The only question here is how to

split that money between "mining" and "manufacturing". The Circuit Court simply has failed to understand that the "value" of an item and the "selling price" of that item at the time of sale mean the same thing in the open market.

But this taxpayer was not, is not, and will not be, willing to sell its rock to itself for depletion computation purposes at a price less than fair market value. The District Court agreed and adopted taxpayer's approach to the problem. The Circuit Court disagreed and reversed, without explaining why the method conflicted with the applicable statute.

There is no such conflict with the statute. Taxpayer's method is in harmony with the statute as interpreted in *Cannelton,* and arrives at a reasonable value of the rock taxpayer produced and shipped. The Circuit Court says: "The government does not try to 'value' the product on the basis of book costs." While the government does not "try" to value the product, the result of its computation is to set an arbitrary "value" on taxpayer's product — government counsel argued (App. 307) that the proportionate profits formula "produces a dollar value per ton." The Circuit Court seems to have been under the misapprehension that the government's method did *not* "produce a dollar value per ton", because it did not reverse the District Court's findings of fact as to such value, and substitute the government's arbitrary "value." The decision was that the "value of the product" was immaterial here —and that its third opinion had used "value" loosely and incorrectly. The third opinion is the one which conforms to the statute and to *Cannelton.*

The District Court judgment following the third Circuit Court opinion and approving the substitute materials method, was correct and should be reinstated as a reasonable and proper method under the statute.

(D) This taxpayer has been prejudiced by the application to it of the proportionate-profits formula instead of the use of a method designed to obtain fair market value.

As previously pointed out, under the statute applicable here all taxpayers other than this taxpayer and possibly two others similarly situated—which two have settled out of court—have each been granted a depletion base equal to the value of the product sold by each. Whether measured by actual sales, or by multiplying units used by an integrated miner-manufacturer times the representative field price of each unit, the gross income from mining figure used in computing the depletion allowance has been the total fair market value of the product sold or used.

The application of the arbitrary proportionate profits formula has resulted in a depletion base for this taxpayer of $1.89 per ton in 1954, $1.61 per ton in 1955, and $1.51 per ton in 1956—as compared with an actual value of $3.70 per ton for each of the years involved. This finding was not altered by the Circuit Court. The resulting depletion allowance is less than half of what this taxpayer is entitled to if it is to receive equal treatment with other taxpayers.

Chemical grade limestone produced by Utah Lime and Stone Co. in the years in question (some of it ultimately being used in the production of cement) sold

for $2.42 per ton f.o.b quarry 40 miles west of Salt Lake City (App. 24, 28). That value was the depletion base for a ton of rock at the quarry of Utah Lime and Stone Co. The value of this taxpayer's cement rock (argillaceous limestone) f.o.b. quarry was $3.70 per ton or over 50% *greater* than the per ton value of the Utah Lime and Stone limestone. This taxpayer's depletion base under the government formula as applied in this case (App. 331, 337, 343) was an average of $\frac{\$378,483.43}{228,309}$ (tonnages App. 347), or $1.66 per ton. This is more than 30% *less* than the per ton depletion base of Utah Lime and Stone Company's material. This taxpayer was arbitrarily assigned a depletion base of 45% of the value of its mineral product at cut-off, while Utah Lime and Stone Co. obtained a depletion base of 100% of the value of its mineral product at cut-off—a price set in the marketplace, with both being in the same depletion rate category, and with the rock from both being used in the production of cement.

In fairness and justice, under the identical depletion statute, this taxpayer is entitled to a depletion base equal to the value at cut-off of its rock shipped to its plant and used by it to make cement; otherwise, there has been a confiscation of a capital asset without just compensation, and to a degree much greater than may have been the case with the other taxpayers whose depletion bases have been the value at cut-off of their products. The application of the government's arbitrary "proportionate profits" formula to this taxpayer has resulted in gross prejudice in this instance.

The Circuit Court intimated that its opinion might have been different had this taxpayer proved to its satisfaction that there was prejudice involved:

> "We will agree with the taxpayer that the government method may penalize the low-cost miner because high mining costs, in relation to total costs, increase the percentage of profit attributable to mining and thus increase the depletion base. In brief and argument the taxpayer asserts that it is a low-cost operator and, hence, prejudiced by the formula. The difficulty is that the record contains no proof to this effect. The taxpayer has failed to convince us that it is a low-cost operator which is penalized for that reason by the proportionate-profits method."

In requiring that taxpayer convince the Circuit Court that it was prejudiced, the Circuit Court has usurped the function of the trial court. Taxpayer adequately convinced the District Court that it was being prejudiced, as indicated in the District Court's statement (App. 216):

> "You are taking a fraction of costs, or a ratio, and you are using that fraction applied to gross revenue to determine the revenue on which you will allow 15 per cent depletion. And the trouble with it is that fraction that you are using is a fraction of operating costs up there in the canyon and nothing else, and it doesn't include a dime for your rock, not one thin dime; and, if it doesn't, you are taxing the taxpayer on something that is not income, within the meaning of the Sixteenth Amendment and within the meaning of the revenue law."

The District Court wanted no further evidence of discrimination or prejudice. The District Court may well have taken a different position, required other evidence,

and conducted further proceedings, if the Circuit Court instructions to it had been otherwise.

As a matter of fact, although all of this may not appear in the findings of fact, due to the Circuit Court's instructions in its third opinion making such appear unnecessary, this taxpayer established: that it was one of 20 producers of cement from a single deposit of rock; that the great bulk of the cement produced is by operators who must mine, or buy from miners, of two, three or more deposits in order to obtain their raw materials; that it is a low-cost operator relative to any multiple deposit producer of comparable volume; and that as to at least one producer of limestone, some of which is used in cement making, its costs of mining are low in relation to the value of its rock.

This taxpayer is not a low-cost miner on an absolute per-ton basis when compared with a multiple quarry producer of much greater volume. A three-quarry producer, for example, with three times the volume of this taxpayer, can equal or better this taxpayer's mining costs per ton. But such a volume producer will also greatly better this taxpayer's manufacturing cost per ton, so that the proportion of this taxpayer's mining costs to its mining-plus-manufacturing costs is still lower than that proportion (mining costs divided by mining-plus-manufacturing costs) of the big volume producer's costs.

The major reason a small volume producer with a single deposit, well located with respect to its market, can compete with a big volume producer against the advantages its size gives—lower interest rates, advan-

tageous freight rates, better prices in general, higher efficiency from machinery, etc.—is due to the value of its deposit. To give a producer from a less valuable deposit or deposits, less well located, a larger depletion allowance—because of its *size*—than a small producer with a more valuable deposit, is unjust and arbitrary.

The matter of being a low-cost or high-cost miner is beside the point of the Circuit Court's fourth opinion when it is examined carefully. If the value at cut-off of its mineral product *is not* its gross income from mining, then taxpayer is out of court regardless of any question of its being a low-cost miner. If the value at cut-off of its product *is* its gross income from mining, then the government's formula is wrong and the taxpayer's is correct, regardless of any question of low-cost mining. If the government's arbitrary formula is found valid and acceptable under the statute, it is beyond attack by reason, and any question of prejudice becomes immaterial since an arbitrary formula is necessarily discriminatory and prejudicial. The presumption in favor of the government concludes the issue.

If the taxpayer has totally failed—which it did not—to put on any further evidence than that sufficient to establish the arbitrariness of the government formula and the reasonableness of its own, the real fair market value at cut-off of its product shipped and the less than one-half actual value resulting from the government's determination of "value" at cut-off, it would still have presented all that was necessary under the Tenth Circuit Court's third opinion herein.

II

THE TENTH CIRCUIT COURT OPINION HAS VIOLATED THE FIFTH AMENDMENT IN DENYING DUE PROCESS OF LAW.

In its third opinion herein, the Circuit Court instructed the District Court:

> "'" . . . mining terminates at the end of primary crushing. This means that the depletion allowance applies to the value of the product at that cut-off point."

Taxpayer presented its case assuming the Circuit Court meant what it said, and the District Court determined the value at cut-off of the product shipped in accordance with that instruction.

Now, in its fourth opinion, the Circuit Court reverses itself, saying:

> "We decline to equate value of product with gross income from mining in the circumstances here presented."

And in footnote 11, it explains:

> " . . . in our third decision in this case . . . reference is made to 'value' of the product. This loose use of the term 'value' cannot change the statute."

Without explaining what it did mean to say by its third opinion, and without hearing argument on the point, the Circuit Court puts the taxpayer out of court. The Circuit Court did not say: We made a misleading mistake in our instruction to the District Court, and here is what we wanted done; now re-try the case in

the light of our corrected instruction. Rather it simply throws this taxpayer out of court.

This taxpayer argued against the proportionate profits formula in each of its four briefs on appeal, basing its argument on the assumption that *Cannelton* was correct—that the value of the mineral product at cut-off was intended by Congress to be the depletion base. The Circuit Court in its third opinion confirmed this assumption. The fourth trial proceedings were based upon this assumption. At no time until the handing down of the fourth opinion of the Circuit Court was this assumption questioned by anyone—the government, the District Court, or the Circuit Court on oral argument before it. The government did not argue to the District Court that the depletion base (i.e., gross income from mining) was not the value at cut-off of the product shipped. In his concluding argument to the District Court, government counsel said (App. 307):

> "The only real difference between the two methods of computation, your Honor, is that ours produces a dollar value per ton on this rock of about $1.80 in the year 1954; the taxpayer's computation produces a dollar value of about $3.70 in the same year.
>
> But I think, if your Honor studies these two computations carefully, your Honor will find that these two computations are both seeking to determine the same thing, namely the depletion deduction which must be assumed, when the taxpayer elects percentage depletion, to be the amount needed to compensate him for the rock in the ground."

At no time in brief or oral argument before the Circuit Court did the government argue that the value

at cut-off of the mineral product was not the "statutory gross income from mining."

In Treasury Regulation 118 Sec. 39.23 (m)-1(e) (3) immediately following the proportionate profits formula is this provision:

> " . . . If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such method."

This clearly indicates that an objective, real value is sought rather than a purely arbitrary calculation. Further, a reading of the entire Regulation (which includes both the proportionate profits formula and the representative field price approach) clearly implies that all methods of approach were *thought* to be non-arbitrary in arriving at value. But a careful analysis reveals that the proportionate profits method is in fact clearly arbitrary.

The Circuit Court in its third opinion sent the matter back for further determination by the District Court of the validity of this proportionate profits approach and with the instruction that it was a matter for the courts to determine. Now, in its fourth opinion the Circuit Court completely disregards the findings of the District Court, and holds that the value at cut-off is not statutory gross income from mining under the facts of this case. Rehearing for the purpose of arguing this issue was denied. The Circuit Court refused to clarify its confusing opinion in any manner,

and gave only the instruction to accept the government formula. The Circuit Court has decided a novel point of law without any hearing on that point, and in a way that conflicts with the uniform usage of the word "value" in any objective dollar amount context. This directly conflicts with this Court's usage of the word "value" in *Cannelton.*

This procedure is a denial of due process of law. This taxpayer has in fact been given no opportunity to be heard in opposition to the foregoing proposition or to present a case to the District Court based upon a corrected instruction to it, which may well have required presentation of different factual material requiring different findings of fact.

At no place in the Circuit Court's fourth opinion has it indicated that any single finding of fact of the District Court was not supported by adequate evidence. In effect the Circuit Court reversed the ultimate conclusions of the District Court, without in any way holding that the taxpayer's method of determining value was wrong as a matter of law. The Circuit Court did, however, usurp the prerogative of the District Court in stating that the taxpayer's method may not be applied under the facts of this case.

If this case is simply a matter of choice between two "reasonable" methods, then the District Court's findings have been made and they are entitled to prevail.

The District Court followed the precise instructions of the Circuit Court. When, in its fourth opinion the Circuit Court stated in effect that the instructions

were worded "loosely," it did not send the matter back for further proceedings so that the District Court could comply with a corrected mandate. Instead, it has rendered its own decision and has reversed the matter based upon the proposition that "value of the product shipped" is not "gross income" without permitting a hearing on that proposition. This constitutes a denial of due process.

In addition, as pointed out in part (D) above, all taxpayers other than this taxpayer and possibly two others similarly situated, have each been granted a depletion base equal to the value of the product sold by each. The failure to give this taxpayer equal treatment with the others under Section 613 of the Internal Revenue Code—by granting it a depletion base equal to the total fair market value of its product shipped, as was done with the other taxpayers under that statute, is a denial of due process.

CONCLUSION

If this Circuit Court opinion is allowed to stand: (1) we are back to the pre-*Cannelton* era, where subsidies are given to high-cost miners, and depletion allowances vary with costs of mining and manufacturing and the selling prices of finished products obtained by expensive manufacturing processes, and where the depletion allowance is not controlled by the value at cut-off of the mineral product or by the value of the raw material in place; (2) depletion allowances are determined (where the proportionate profits formula is applicable) by an arbitrary formula, variable at the whim of the Internal Revenue Agent involved, which

cannot be attacked on rational grounds, and with all the evils of discrimination and corruption which that implies, and (3) this taxpayer's capital assets in the form of cement rock consumed and sold as cement, have been seized by taxation resulting from a depletion base less than one-half of fair market value, when nearly all other taxpayers have been granted full fair market value as the depletion base. These results are all contrary to *Cannelton,* contrary to the procedure followed with every other taxpayer having a market at cut-off (including limestone and calcium carbonate producers and cement manufacturers), and contrary to basic justice and due process of law—created by an opinion of the Tenth Circuit Court of Appeals which was based upon a novel proposition against which this taxpayer has never had an opportunity to present its argument.

This Court should take the time to consider this matter in detail and depth, and to replace percentage depletion law on the *Cannelton* foundation by striking down the proportionate profits formula.

Respectfully submitted,

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IN THE UNITED STATES DISTRICT COURT DISTRICT OF UTAH, CENTRAL DIVISION

PORTAND CEMENT COMPANY OF UTAH,
a Utah Corporation, *Plaintiff,*

vs.

UNITED STATES OF AMERICA,
Defendant.

No. C-12-60

Findings of Fact, Conclusions of Law and Judgment

Glen E. Fuller, Jack R. Decker, 15 East Fourth South Street, Salt Lake City, Utah, for plaintiff. A. Pratt Kesler, United States Attorney, C. Nelson Day, Assistant United States Attorney, 200 Federal Building, Salt Lake City, Utah, John F. Murray, Tax Division, Department of Justice, Washington 25, D.C. for defendant.

RITTER, District Judge: The above-entitled cause having come on regularly for trial on the 1st day of June, 1960, Glen E. Fuller and Jack R. Decker, attorneys, appearing for and on behalf of the plaintiff, and John F. Murray of the Tax Division, U.S. Department of Justice, Washington, D.C., appearing for and on behalf of the defendant; and evidence, both oral and documentary, having been introduced and received by the court, an both parties having rested, and the court being fully advised in the premises now makes the following:

Findings of Fact

1. Jurisdiction in this matter is conferred upon the court by Section 1846, Title 28, United States Code Annotated.

2. The former Portland Cement Company of Utah, a Wyoming corporation, was engaged in the mining of cement rock from its own quarry and the manufacture therefrom of cement, during the years 1954, 1955 and 1956; and in 1958, said corporation merged with the Snow-Pym Corporation, a Utah corporation, forming the plaintiff Portland Cement Company of Utah, a Utah corporation, under and by reason of which merger plaintiff succeeded to and acquired all the rights of action of Portland Cement Company of Utah, a Wyoming corporation.

3. Plaintiff's cement plant now is, and was during the years 1954, 1955 and 1956, located at Eighth South Street and Fifth West Street in Salt Lake City, Utah; and said company had its offices at 24 East Fourth South Street, Salt Lake City, Utah. Its quarry was at such time, and still is, located twelves miles east of the cement plant in Parley's Canyon.

4. During each and all of said years, plaintiff was, and now is, engaged solely in the mining of an argillaceous limestone with constituents in ideal chemical and physical proportion and combination for cement manufacture, and in the processing of this rock into finished cement. This mineral is known in the trade as "cement rock", and plaintiff's deposit has value for no other purpose.

5. In processing said cement rock into finished cement, plaintiff first blasted the rock out of a mountainous quarry face, and further reduced the rock by secondary blasting of large boulders which were obtained; the rock was then crushed in a gyratory crusher to sizes of two to four inches rough diameter, plus "fines" ranging in size down to splinters. The crushed material was then transported to the plant in Salt Lake City where the rock was further crushed to three-fourth inch rough diameter size. The rock was then ground in ball mills to a fineness of 90% in volume passing through a 200 mesh sieve, and water was added in the ball mills, forming a "slurry", which is a very fine mud. The slurry was placed in tanks where it was mixed and made uniform; and after such mixing it was fed into rotary kilns where it was sintered. The resulting clinker was cooled and later ground into cement, which was stored in silos for future sale. In the final mixing tank, it was customary to add on occasions either high lime mixture or high silica mixture in order to balance the chemical compositoin of the slurry in order to maintain uniformity of product; and gypsum was added to the clinker prior to grinding in order to retard the set of concrete which would subsequently be made from the cement.

The foregoing processes were the treatment processes normally applied by this plaintiff and other similar mine owners and operators in the production of cement.

6. The average chemical analysis of plaintiff's cement rock, determined by the oxide basis of analysis was about 42% CaO, 18% SiO^2, 2% to 3% Al^2O^3,

2% to 3% Fe^2O^2, trace elements of the alkalies, plutonium and manganese, and small amounts of magnesium carbonate.

7. The approximate cost per ton of blasting and primary crushing of plaintiff's cement rock at the quarry were $1.34 in 1954 ,$1.23 in 1955 and $1.15 in 1956. The freight cost per ton of hauling the rock to the cement plant were $.62 in 1954, $.62 in 1955 and $.66 in 1956.

8. Plaintiff has never sold any of the cement rock it produced, nor made any other use of it than to make cement. Fines produced at the quarry have had to be hauled away at plaintiff's expense for lack of any market; and when a highway was cut through plaintiff's deposit, the road builders did not use the cement rock, but rather hauled in other materials.

9. There were and now are available throughout the area served by plaintiff, ample deposits of gravel and fill materials. Gravel can and could be purchased for 5c to 7c per yard maximum price, and fill can and could be purchased for a maximum price of 2c per yard, there being about 1½ to 1¾ tons per yard.

10. There is not a product which plaintiff produced, or which it might have produced, from its cement rock deposit which was or is readily marketable or commercially marketable, prior to the production of finished cement. The location of the deposit is in a narrow canyon where considerations of accessibility to transportation, to possible markets, available area for storage of materials and location of necessary machinery, equipment and operations involving blasting and crushing, completely preclude the sale of said material for road

and construction purposes or any other use other than the production of cement.

The product sold by the plaintiff was at all times the first commercially marketable product obtainable from its cement rock deposit.

11. When the depletion allowance is computed upon the first commercially marketable product obtained from the cement rock deposit by applying treatment processes normally applied by mine owners or operators having similar deposits, plaintiff is entitled to an additional deduction over that allowed by defendant on plaintiff's income tax returns for 1954, 1955 and 1956; and as a result of these increased deductions, plaintiff is entitled to a refund of taxes for the year 1954 of $62,996.02, plus interest in the sum of $19,843.75; for the year 1955 of $54,741.04, plus interest in the sum of $13,958.97; and for the year 1956 of $57,558.51, plus interest in the sum of $11,222.92.

12. Plaintiff filed with defendant, within the time allowed by law, claims for refund of the amounts of tax paid as a result of the lower depletion allowance permitted by defendant, and on January 20, 1960, plaintiff received notice that the said claims for refund were refused. This action was brought more than six months subsequent to the filing of said claims for refund.

From the foregoing Findings of Fact, the court makes the following:

Conclusions of Law

1. That under the provisions of the 1954 Internal Revenue Code, the first commercially marketable min-

eral product obtained from plaintiff's property upon which plaintiff is entitled to depletion is finished cement.

2. The method used by plaintiff in its mining operations resulting in the production of finished cement involved processes which were and are the ordinary treatment process normally applied by plaintiff and other similar mine owners and operators in order to obtain the first commercially marketable mineral product.

3. Plaintiff is entitled to a percentage depletion rate of 15% as provided by, and subject to, the provisions of Section 613 and other applicable portions of the Internal Revenue Code of 1954.

4. Plaintiff is entitled to a refund of tax from the defendant for the year 1954 in the sum of $62,996.02, plus interest in the sum of $19,843.75; for the year 1955 in the sum of $54,741.04, plus interest in the sum of $13,958.97; and for the year 1956 in the sum of $57,558.51, plus interest in the sum of $11,222.92, or a total of $175,295.57 principal and interest of $45,-$25.64, which is a total of $220,321.21.

WHEREFORE, based upon the Findings of Fact and Conclusions of Law, hereinabove separately set forth, it is hereby Ordered that judgment be, and the same is hereby granted and entered in favor of the plaintiff and against the defendant in the sum of Two Hundred Twenty Thousand Three Hundred Twenty-One and 21/100 Dollars ($220,321.21), together with interest as provided by law.

B-1

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 6591 MARCH TERM 1961

UNITED STATES OF AMERICA,
Appellant,

vs.

PORTAND CEMENT COMPANY OF UTAH,
a Utah Corporation, *Appellee.*

Appeal from the United States District Court
for the District of Utah

Abbott M. Sellers, Acting Assistant Attorney Gen, eral, Louis F. Oberdorfer, Assisting Attorney General, and Lee A. Jackson, Melva M. Graney and James P. Turner, Attorneys, Department of Justice, for Appellant

Glen E. Fuller and Jack R. Decker, for Appellee

Before MURRAH, Chief Judge, PICKETT, Circuit Judge, and SAVAGE, United States District Judge.

SAVAGE, District Judge

In this income tax refund case the United States appeals from a judgment in favor of the taxpayer for taxes paid under protest for the years 1954 through 1956. The controversy arose over the computation of the statutory depletion allowance to the taxpayer in the mining and processing of cement rock into cement. The Internal Revenue Code of 1954, § 613, which was in

effect during the tax years in question, provides that in the case of mines there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion which shall be a percentage of the gross income from mining. The schedule of percentage depletion rates provides for a 15% depletion allowance for "all other minerals, (including but not limited to) * * calcium carbonates * * * limestone." The term "mining" includes "not merely the extraction of the ores or minerals from the ground, but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products * *."

The findings were that the taxpayer was engaged in the mining of an argillaceous limestone from its own quarry located in a canyon twelve miles east of its processing plant in Salt Lake City, Utah. It was mining a kind of limestone known in the trade as cement rock, which was desirable for making cement but had value for no other purpose. Cement rock may be processed into finished cement without the necessity of blending and mixing many isolated products, which is required in the manufacture of cement from ordinary limestone. The ingredients found in cement rock are mixed in a solid solution in such a manner as to constitute an ideal mineral in its natural state for producing cement.

In processing its cement rock into finished cement, the taxpayer resorted to procedures normally applied by other similar mine owners and operators. It blasted the rock out of a mountainous quarry face and reduced the size by secondary blasting of large boulders which

were obtained. The rock was then crushed in a gyratory crusher to sizes two to four inches rough diameter plus "fines" ranging in size down to splinters. The usable material was then transported to the plant in Salt Lake City where it was further crushed to three-fourths inch rough diameter size. It was then ground in ball mills to a fineness of 90% in volume, passed through a 200 mesh sieve and water was added forming a "slurry", which is a very fine mud. The slurry was placed in tanks where it was mixed and made uniform and then fed into rotary kilns and sintered. The resulting clinkers were cooled and later ground into cement, which was stored in silos for future sale.

The taxpayer has never sold any of the crushed cement rock it produced nor made any use of it other than to make cement. "Fines" produces at the quarry were disposed of as waste material for lack of any market. Cement rock is not suitable for use as road base material. When a highway was cut through the taxpayer's deposit the cement rock was pushed aside and other materials hauled in for the road bed.

The problem presented is whether depletable gross income from mining is that realized from the sale of finished cement, as contended by the taxpayer and decided by the trial court, or whether it is limited to the constructive income from crushed cement rock as contended by the government. The government asserts that the taxpayer is an integrated miner-manufacturer; that its mining operations terminate when the mineral is converted into crushed limestone, and that the subsequent processing into finished cement is a manufacturing operation. This argument would be un-

assailable except for the statutory definition of "mining" as including "ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." This definition may under the facts of a particular case take us well beyond the ordinary concept of mining opertions.

The cement rock mined by the taxpayer unquestionably was not salable at the market at any stage of processing until it became finished cement. But the government points out that only the treatment processes which are normally applied by miners are encompassed within mining and that "mining" is limited to the basic marketable product of each branch of the mining industry; that mining needs when the mineral reaches the point at which it may by industry standards be sold, and that any unusual or abnormal processing resorted to by the taxpayer would not be embraced in the mining operations.

The taxpayer urges that, because the location of the mineral deposit is such a vital factor in determining its value, only the local market may be relied upon to reflect the true value of the mineral. Taxpayer would look only to the availability of a local market for its products in deciding at what stage of processing a commercially marketable product had been obtained. This was the test applied by the trial court, which found that the taxpayer produced no product from its cement rock deposit which was commercially marketable, nor could have, prior to its conversion into finished cement. The court further found that the location of the deposit in a narrow canyon precluded the sale for

road and construction purposes.[1] Evidence offered by the government in support of its theory as to the first marketable product of the mining industry of which taxpayer is a part was excluded.

If the statutory provision for including "ordinary treatment processes normally applied by mine owners or operators" (left the issue in doubt, it was set at rest by the Supreme Court in United States v. Cannelton Sewer Pipe Company, 364 U.S. 76, decided shortly after judgment was entered in this case. There the taxpayer mined fire clay and shale at Cannelton, Indiana, which was processed into sewer pipe and other vitrified articles. Because it could not profitably sell its raw fire clay and shale, taxpayer contended that its percentage depletion was properly based upon its gross sales of finished products. The government contended that an industry-wide test should be applied. The findings were that during 1951, the tax year in question, there were substantial sales of raw fire clay and shale in Indiana. In Kentucky, across the river taxpayer's plant, fire clay and shale of the same grade were mined and sold. Since 1957, the taxpayer had secured all of its mineral requirements from this source by lease under which the lessor mined and delivered the raw material. In holding that fire clay and shale

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1. Finding 10 was: "There is not a product which plaintiff produced, or which it might have produced, from its cement rock deposit which was or is readily marketable or commercially marketable, prior to the production of finished cement. The location of the deposit is in a narrow canyon where considera-toins of accessability to transportation, or possible markets, available area for storage of materials and location of necessary machinery, equipment and operations, involving blasting and crushing, completely preclude the sale of said material for road and construction purposes or any other use other than the production of cement."

were "commercially marketable" in their raw state, the court rejected the argument that such phrase implied marketability at a profit. "It would be strange, indeed," said the Court, "to ascribe to the Congress an instant to permit each miner to adopt processes peculiar to his individual operation."

Proceeding from the sound premise that an industry-wide test must be applied, the government next argues that the taxpayer is a part of the limestone mining industry and that the basic marketable product of such industry is crushed limestone. While conceding that cement rock is a specie of limestone, the taxpayer asserts that cement rock is a mineral in its own right and is recognized as such by statute, by treasury regulations and by court decisions.

The statutory list of "all other minerals" to be accorded a 15% depletion allowance included "calcium carbonates" and "limestone". Cement rock is not listed by that name but it is one of the calcium carbonates as well as a type of limestone. Treasury Regulations 118, §39.23(m)-5(b), significantly provides:

> "For the purpose of this section, the minerals indicated below shall have the following meanings:
>
> " 'Calcium carbonate * * * Miscellaneous limestones and other calcium carbonate rocks * * such as cement rock and limestone used or sold for use in soil treatment. This classification does not include rocks or minerals used or sold for use as ballast, road making, concrete aggregates or other purposes for which chemical composition is not a major requirement."

In Dragon Cement Company v. United States, 1 Cir., 244 F. 2d 513, the controversy, as in our case, was over the depletion allowance to be granted a taxpayer who quarried cement rock for processing into cement. After tracing the legislative history of depletion laws, the court observed:

> "By §319 of the Revenue Act of 1951 (65 Stat. 497), the Congress amended § 114(b)-(4)(A) of the Internal Revenue Code so as to extend the availability of percentage depletion for the first time to 'calcium carbonates' which includes deposits of cement rock, the natural resource involved in the case at bar."

We agree with the taxpayer that its cement rock deposit is more accurately classified for our purposes as a "calcium carbonate". While cement rock may properly be characterized as limestone, there are many grades of limestone and many different limestone industries.[2]

We conclude that a decision of this case requires a finding based upon a consideration of relevant evidence as to "the ordinary treatment processes normally applied by" cement rock "miners or operators in order to obtain the commercially marketable mineral product or products."

The ultimate disposition of this litigation will require further analysis and application of the Supreme Court's Cannelton case. The government contends that

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2. See C.I.R. v. Iowa Limestone Co., 8 Cir., 269 F 2d 398: "We do not think that the depletion statute contemplates that all types of limestone be considered the same material. This was apparently the Tax Court's thought when it stated:

'Limestone is divided commerically into three large fields i.e., chemical and manufacturing industries, building industries, and agriculture. * * * ' "

Cannelton holds that the term "ordinary treatment processes" refers to mining processes, and the dependent clause, "normally applied * * to obtain the commercially marketable mineral product", permits only the inclusion of processes which are necessary to make the mineral suitable for commercial or industrial use. It asserts that, even if cement rock is treated as a separate branch of industry in which every miner is also a manufacturer of cement, the ordinary treatment processes included in mining would terminate with the crushing operation for at that point the mineral can be shipped to a manufacturer for processing. Cannelton, as the government reads it, requires a conclusion that, even if there be no market for crushed cement rock because all cement rock miners are also cement manufacturers, for depletion purposes the taxpayer manufacturer will be considered as purchasing from himself as a miner the raw materials used in making cement.

The taxpayer insists that such an interpretation of Cannelton is not warranted by the facts because there substantial quantities of the crude mineral products mined in the area were sold in the raw state. In addition, the taxpayer relies on our decision in United States v. Sapulpa Brick and Tile Corporation, 239 F. 2d 694, where we held, upon findings that only a negligible quantity of the brick and tile clay was or could be sold, that the first commercially marketable products were burnt brick and tile. Our decision followed that of the Fifth Circuit in United States v. Cherokee Brick & Tile Co., 218 F. 2d 424, and the Fourth Circuit in Townsend v. Hitchcock Corporation,

232 F. 2d 444.[3] These decisions were not overruled by the Supreme Court in Cannelton but the government argues they are no longer "authoritative". The court thought "it is sufficient to say that on their facts they are all distinguishable."

At a new trial and after making essential findings of fact, the trial court will be afforded an opportunity for the first time to decide this case in the light of the Supreme Court's Cannelton decision.

Reversed and remanded.

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3. See also, Dragon Cement Company, 1 Cir., 244 F. 2d 513; United States v. Merry Bros. Brick & Tile Co., 5 Cir., 242 F. 2d 708.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

PORTAND CEMENT COMPANY OF UTAH,
a Utah Corporation, *Plaintiff*,

vs.

UNITED STATES OF AMERICA,
Defendant.

No. C-12-60

Findings of Fact, Conclusions of Law and Judgment

The above-entitled cause having come on regularly for trial on the 8th day of December, 1961, Glen E. Fuller and Jack R. Decker, attorneys, appearing for and on behalf of the plaintiff, and Harvey G. Schneider of the Tax Division, U. S. Department of Justice, Washington, D.C., appearing for and on behalf of the defendant; and evidence, both oral and documentary, having been introduced and received by the court, and both parties having rested, and the court being fully advised in the premises now makes the following:

Findings of Fact

1. Jurisdiction in this matter is conferred upon the court in Section 1346, Title 28, United States Code Annotated.

2. The former Portland Cement Company of Utah, a Wyoming corporation, was engaged in the

mining of cement rock from its own quarry and the processing therefrom of cement, during the years 1954, 1955 and 1956; and in 1958, said corporation merged with the Snow-Pym Corporation, a Utah corporation, forming the plaintiff Portland Cement Company of Utah, a Utah corporation, under and by reason of which merger plaintiff succeeded to and acquired all the rights of action of Portland Cement Company of Utah, a Wyoming corporation.

3. Plaintiff's cement plant now is, and was during the years 1954, 1955 and 1956, located at Eighth South Street and Fifth West Street in Salt Lake City, Utah; and said company had its offices at 24 East Fourth South Street, Salt Lake City, Utah. Its quarry was at such time, and still is, located twelve miles east of the cement plant in Parley's Canyon.

4. During each and all of said years, plaintiff was, and now is, engaged solely in the mining of an argillaceous limestone with constituents of ideal chemical and physical proportion and combination for cement manufacture, and in the processing of this rock into finished cement. This mineral is known in the trade as "cement rock", and plaintiff's deposit has value for no other purpose.

5. In processing said cement rock into finished cement, plaintiff first blasted the rock out of a mountainous quarry face, and further reduced the rock by secondary blasting of large boulders which were obtained; the rock was then crushed in a gyratory crusher to sizes of two to four inches rough diameter, plus "fines" ranging in size down to splinters. The

crushed material was then transported to the plant in Salt Lake City where the rock was further crushed to three-fourth inch rough diameter size. The rock was then ground in ball mills to a fineness of 90% in volume passing through a 200 mesh sieve, and water was added in the ball mills, forming a "slurry", which is a very fine mud. The slurry was placed in tanks, where it was mixed and made uniform, and after such mixing it was fed into rotary kilns where it was sintered. The resulting clinker was cooled and later ground into cement, which was stored in silos for future sale. In the final mixing tank, it was customary to add on occasions either high lime mixture or high silica mixture in order to balance the chemical composition of the slurry in order to maintain uniformity of product; and gypsum was added to the clinker prior to grinding in order to retard the set of concrete which would subsequently be made from the cement.

6. The treatment processes applied by plaintiff taxpayer were and are the ordinary treatment processes normally applied by cement rock miners or operators throughout the United States in the production of cement.

The average chemical analysis of plaintiff's cement rock, determined by the oxide basis of analysis was about 42% CaO, 18% SiO^2, 2% to 3% Al^2O^3, 2% to 3% Fe^2O^3, trace elements of the alkalies, plutonium and manganese, and small amounts of magnesium carbonate.

8. The approximate cost per ton of blasting and primary crushing of plaintiff's cement rock at the

quarry were $1.34 in 1954, $1.23 in 1955 and $1.15 in 1956. The freight cost per ton of hauling the rock to the cement plant were $.62 in 1954, $.62 in 1955 and $.66 in 1956.

9. Plaintiff has never sold any of the cement rock it produced, nor made any other use of it than to make cement. Fines produced at the quarry have had to be hauled away at plaintiff's expense for lack of any market; and when a highway was cut through plaintiff's deposit, the road builders did not use the cement rock, but rather hauled in other materials.

10. There were and now are available throughout the area served by plaintiff, ample deposits of gravel and fill materials. Gravel can and could be purchased for 5c to 7c per yard maximum price, and fill can and could be purchased for a maximum price of 2c per yard, there being about 1½ to 1¾ tons per yard.

11. There is not a product which plaintiff produced, or which it might have produced, from its cement rock deposit which was or is marketable prior to the production of bulk cement. Cement rock, as defined in the trade and in scientific textbooks and works of general reference, is not suitable for any purpose other than processing into cement, there being an abundance of other suitable materials in all parts of the nation for all other industrial uses. In fact, there is no market at all for cement rock in any form in the general area of the taxpayer, in any of the surrounding states, or anywhere in the entire United States prior to its sale as bulk cement.

The bulk cement sold by the plaintiff was at all times the first and only commercially marketable product obtainable from its cement rock deposit. Cement is the first and only commerically marketable product obtainable from any cement rock mined anywhere in the United States.

12. When the depletion allowance is computed upon the first commercially marketable product obtained from the cement rock deposit by applying treatment processes normally applied by mine owners or operators having similar deposits, plaintiff is entitled to an additional deduction over that allowed by defendant on plaintiff's income tax returns for 1954, 1955 and 1956; and as a result of these increased deductions, plaintiff is entitled to a refund of taxes for the year of 1954 of $62,996.02, plus interest to and including December 15, 1961, in the sum of $25,526.31; for the year 1955 of $54,741.04, plus interest in the sum of $18,896.85; and for the year 1956 of $57,558.51, plus interest in the sum of $16,416.05.

13. Plaintiff filed with defendant, within the time allowed by law, claims for refund of the amounts of tax paid as a result of the lower depletion allowance permitted by defendant, and on January 20, 1960, plaintiff received notice that the said claims for refund were refused. This action was brought more than six months subsequent to the filing of said claims for refund.

From the foregoing Findings of Fact, the court makes the following:

Conclusions of Law

1. That under the provisions of the 1954 Internal Revenue Code, the first commercially marketable mineral product obtained from plaintiff's property upon which plaintiff is entitled to depletion is bulk cement.

2. The method used by plaintiff in its mining operations resulting in the production of bulk cement involved only processes which were and are the ordinary treatment processes normally applied by plaintiff and other cement rock mine owners or operators in order to obtain the first commercially marketable mineral product.

3. Plaintiff is entitled to a percentage depletion rate of 15% as provided by, and subject to, the provisions of Section 613 and other applicable portions of the Internal Revenue Code of 1954.

4. Plaintiff is entitled to a refund of tax from the defendant for the year 1954 in the sum of $62,996.02, plus interest in the sum of $25,526.31; for the year 1955 in the sum of $54,741.04, plus interest in the sum of $18,896.85; and for the year 1956 in the sum of $57,-558.71, plus interest in the sum of $16,416.05, or a total of $175,295.57 principal and interest to and including December 15, 1961, of $60,839.21, which is a total of $236,134.78.

WHEREFORE, based upon the Findings of Fact and Conclusions of Law, hereinabove separately set forth, it is hereby Ordered that judgment be, and the same is hereby granted and entered in favor of the plaintiff and against the defendant in the sum of Two

Hundred Thirty-Six Thousand One Hundred Thirty-Four and 78/100 Dollars ($236,134.78), together with interest as provided by law.

WILLIS W. RITTER
Chief Judge

Entered December 15, 1961.

D-1

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

November Term - 1962

UNITED STATES OF AMERICA,

Appellant,

vs.

PORTAND CEMENT COMPANY OF UTAH,
a Utah Corporation,

Appellee.

Number 7028

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF UTAH, CENTRAL DIVISION

Melva M. Graney, Attorney, Department of Justice, (William T. Thurman, United States Attorney, Louis F. Oberdorfer, Assistant Attorney General, Lee A. Jackson, Attorney, Department of Justice, and Robert L. Waters, Attorney, Department of Justice, were with her on the brief) for Appellant.

Glen E. Fuller (Jack R. Decker was with him on the brief) for Appellee.

Before BRATTON, LEWIS and SETH, Circuit Judges.

BRATTON, Circuit Judge:

Portland Cement Company of Utah, a so-called miner-manufacturer, sought in this action to recover refund of income taxes paid for the years 1954, 1955, and 1956. Legal right to the refund was asserted on the ground that the base for depletion allowance of the taxpayer was sales of finished cement, not a certain kind of limestone. Judgment was entered for the taxpayer. On appeal, the judgment was reversed and the cause was remanded for a new trial. Unied States v. Portland Cement Company of Utah, 293 F.(2d) 826. The cause was again tried, evidence was adduced, and judgment was again entered for the taxpayer.

The taxpayer mined from its own quarry in Utah a kind of limestone known in the trade as cement rock, and it manufactured cement. The opinion of this court on the former appeal contains in clear detail a statement of the procedures by which such integrated business was conducted. On the second trial, the court found these facts. The taxpayer blasted the rock out of the quarry; reduced it by secondary blasting; crushed it by a gyrating crushed to smaller sizes, plus fines ranging down to splinters; transported the crushed product to the cement plant at which place it was further crushed and ground in ball mills, forming a slurry which was very fine mud; the slurry was placed in tanks where it was mixed and made uniform; after the mixing, the slurry was fed into kilns where it was sintered; the resulting clinker was cooled and later ground into cement; and the cement was stored in silos for further sale. The court further found that these processes were the ordinary treatment processes normally applied by cement rock miners or operators throughout the United

States in the production of cement, and that the taxpayer never sold any of the cement rock which it produced or put it to any use other than to make cement. The court further found that the bulk cement sold by the taxpayer was at all times the first and only commercially marketable product obtainable from its cement rock, and that cement was the first and only commercially marketable product obtainable from any cement rock mined anywhere in the United States. And the court concluded in effect that the statutory depletion base of the taxpayer was the income derived from the sale of finished cement.

"In presently pertinent part," section 613 of the Internal Revenue Code of 1954, 26 U.S.C. 1958 ed. §613, provides in effect that in computing net income a specified depletion shall be allowed on limestone and other named minerals; and it defines mining to include the ordinary treatment processes normally applied by mine owners and operators in order to obtain a commercially marketable product or products. Section 114(b)(4)(B) of the Internal Revenue Code of 1939, as amended, 26 U.S.C. 1952 ed. §114(b)(4)(B) was identical. In United States v. Cannelton Sewer Pipe Co., 364 U.S. 76, the taxpayer owned an underground mine in Indiana from which it produced fire clay and shale. The raw material product was transported to the plant of the taxpayer at which it was processed and fabricated into vitrified sewer pipe, flue lining, and related products. In such process, the raw material was ground into a pulverized form about as fine as talcum powder; the powder was mixed with water in a pug mill and became a plastic mass which was formed

by machines into the desired shape of the finished ware. The ware was placed in dryers and subjected to heat to remove all of the water; thereafter the ware was vitrified in kilns; and it was cooled, graded and either shipped or stored. During the taxable year in question there were substantial sales of raw fire clay and shale in Indiana, mostly about 140 miles from the mine and plant of the taxpayer. In Kentucky, across the river from the plant of the taxpayer, fire clay and shale of the same grade as that of the taxpayer were mined and sold before, during, and subsequent to the year in question. And in certain subsequent years to that in question, the taxpayer secured all of its mineral requirements from that source on a lease basis under which the lessor mined and delivered the raw material to the plant of the taxpayer. After reviewing the legislative history of depletion allowances, the court said in substance that the value of the taxpayer's vitrified clay products, obtained by expensive manufacturing processes, bore little relation to the value of its minerals; that depletion was not designed to recompense for costs of recovery but for exhaustion of mineral assets alone; that to extend depletion allowance to the finished product of an integrated miner-manufacturer would enable him to enjoy depletion allowance on his manufacturing costs, including depreciation on his manufacturing plant, machinery, and facilies; and that Congress intended integrated mining-manufacturing operations to be treated as though the operator was selling the mineral mined to himself for fabrication. The judgment in favor of the taxpayer was reversed and the cause was remanded for further proceedings in conformity with the opinion.

In point of material facts, Riddell v. Monolith Portland Cement Co., 301 F.(2d) 488, ... U.S. ...., and this case parallel each other closely. There the taxpayer owned a quarry in California from which it extracted limestone and used all of such product in the manufacture of cement at its plant located nearby. Small amounts of certain other material which the taxpayer mined and some which it purchased were added to the limestone. The processes in making the cement were those normally applied in the cement industry by cement manufacturers having deposits similar to that of the taxpayer. The trial court found that there was no market for the taxpayer's mineral until such time as it was processed into finished cement. Judgment was entered awarding the taxpayer depletion allowance computed on the income from the sale of finished cement. On appeal, the judgment was affirmed; but on certiorari, it was reversed. Citing United States v. Cannelton Sewer Pipe Co., supra, the Supreme Court said in substance that the property of the taxpayer with which the statute allowing depletion dealt was the mineral product when it reached the crushed limestone stage; and that the taxpayer's allowance for depletion was limited to the constructive income received from such crushed limestone. Here, the basis of depletion of the taxpayer is limited in like manner to the constructive income from the limestone when it reached the crushed stage. It does not include finished cement.

The judgment is reversed and the cause is remanded for further proceedings not in conflict with this opinion.

IN THE UNITED STATES DISTRICT COURT DISTRICT OF UTAH, CENTRAL DIVISION

PORTLAND CEMENT COMPANY OF UTAH,
a Utah corporation,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

No. C-12-60

The above-entitled cause having come on regularly for trial on the 13th day of December, 1963, Glen E. Fuller and Jack R. Decker, attorneys, appearing for and on behalf of the plaintiff, and William T. Thurman, U.S. Attorney, and Thomas F. Field of the Tax Division, U. S. Department of Justice, Washington, D.C., appearing for and on behalf of the defendant; and evidence, both oral and documentary, having been introduced and received by the court, and the court having announced its ruling and decision, and having requested that counsel for plaintiff prepare appropriate findings of fact and conclusions of law, and a Judgment, now makes the following:

FINDINGS OF FACT

1. Jurisdiction in this matter is conferred upon the court by Section 1346, Title 28, United States Code Annotated.

2. The former Portland Cement Company of Utah, a Wyoming corporation, was engaged in the mining of cement rock from its own quarry and the processing therefrom of cement, during the years 1954, 1955 and 1956; and in 1958, said corporation merged with the Snow-Pym Corporation, a Utah corporation, forming the plaintiff Portland Cement Company of Utah, a Utah corporation, under and by reason of which merger plaintiff succeeded to and acquired all the rights of action of Portland Cement Company of Utah, a Wyoming corporation.

3. Plaintiff's cement plant now is, and was during the years 1954, 1955 and 1956, located at Eighth South Street and Fifth West Street in Salt Lake City, Utah. Its quarry was at such time, and still is, located twelve miles east of the cement plant in Parley's Canyon.

4. During each and all of said years, plaintiff was, and now is, engaged solely in the mining of an argillaceous limestone with constituents of ideal chemical and physical proportion and combination for cement manufacture ,and in the processing of this rock into finished cement. This mineral is known in the trade as "cement rock", and plaintiff's deposit has value for no other purpose.

5. In processing said cement rock into finished cement, plaintiff first blasted the rock out of a mountainous quarry foe, and further reduced the rock by

secondary blasting of large boulders which were obtained; the rock was then crushed in a gyratory crusher to sizes of two to four inches rough diameter plus "fines" ranging in size down to splinters. The crushed material was then transported to the plant in Salt Lake City where the rock was further crushed to three-fourth inch rough diameter size. The rock was then ground in ball mills to a fineness of 90% in volume passing through a 200 mesh sieve, and water was added in the ball mills, forming a "slurry", which is a very fine mud. The slurry was placed in tanks where it was mixed and made uniform, and after such mixing it was fed into rotary kilns where it was sintered. The resulting clinker was cooled and later ground into cement, which was stored in silos for future sale. In the final mixing tank, it was customary to add on occasions either high lime mixture or high silica mixture in order to balance the chemical composition of the slurry in order to maintain uniformity of product; and gypsum was added to the clinker prior to grinding in order to retard the set of concrete which would subsequently be made from the cement.

The treatment processes applied by plaintiff taxpayer were and are the ordinary treatment processes normally applied by cement rock miners or operators throughout the United States in the production of cement.

7. The average chemical analysis of plaintiff's cement rock, determined by the oxide basis of analysis was about 42% CaO, 18% SiO^2, 2% to 3% Al^2O^3, 2% to 3% Fe^2O^3, trace elements of the alkalies, plutonium

and manganese, and small amounts of magnesium carbonate.

8. Plaintiff has never sold any of the cement rock it produced, nor made any other use of it than to make cement. Fines produced at the quarry have had to be hauled away at plaintiff's expense for lack of any market; and when a highway was cut through plaintiff's deposit, the road builders did not use the cement rock, but rather hauled in other materials.

9. There were and now are available throughout the area served by plaintiff, ample deposits of gravel and fill material. Gravel can and could be purchased for 5c to 7c per yard maximum price, and fill can and could be purchased for a maximum price of 2c per yard, there being about 1½ to 1¾ tons per yard.

10. There is not a product which plaintiff produced, of which it might have produced, from its cement rock deposit which was or is marketable prior to the production of bulk cement. Cement rock, as defined in the trade and scientific books and works of general reference, is not suitable for any purpose other than processing into cement, there being an abundance of other suitable materials in all parts of the nation for all other industrial uses. In fact, there is no market at all for cement rock in any form in the general area of the area of the taxpayer, in any of the surrounding states, or anywhere in the entire United States prior to its sale as bulk cement.

The bulk cement sold by the plaintiff was at all times the first and only commercially marketable product obtainable from its cement rock deposit. Cement

is the first and only commercially marketable product obtainable from any cement rock mined anywhere in the United States.

11. Plaintiff filed with defendant, within the time allowed by law, claims for refund of the amounts of tax paid as a result of the lower depletion allowance permitted by defendant, and on January 20, 1960, plaintiff received notice that the said claims for refund were refused. This action was brought more than six months subsequent to the filing of said claims for refund.

This matter was remanded to this court for a determination of the constructive income from taxpayer's mineral when it reached the crushed stage, thereby requiring that additional evidence be taken to ascertain the depletion base and depletion allowance.

12. The term "crusher" is properly applied to any rock size reduction machine in which the crushing elements do not come in contact with each other even in the absence of material to be crushed.

The term "grinder" is properly applied to any rock size reduction machine in which the grinding elements do come in contact with each other in the absence of material to be crushed, which would normally hold them separated.

13. The taxpayer's primary "gyratory crusher" at its quarry and its secondary "impact crusher" at its plant location were both crushers in which the crushing elements did not come in contact with each other even in the absence of material to be crushed.

The taxpayer's "ball mills" at its plant location were grinders in which grinding elements came in contact with each other in the absence of material to be crushed.

14. No material is suitable or usable in cement processing until after it has been reduced in size to 3/4 inch or less. No cement company, whether using cement rock or other materials, begins its cement making processes with materials of larger size.

15. The taxpayer's mineral deposit is of a very rare type which is, and was, in the years under dispute more valuable and more desirable for the purpose of use as a raw material in cement processing than Monolith's California deposit, or local deposits of chemical limestone such as that sold to taxpayer by Utah Lime and Stone Co. or deposits in other areas of limestone used as a raw material in cement processing.

16. "Cement rock" is, and has been since 1908, recognized in the Minerals Yearbook officially published by the United States Department of Interior as a mineral distinct from other types of limestone which may be used, together with other necessary minerals in the processing of cement.

17. No mineral of the like kind and grade to taxpayer's has ever been sold locally, in the State of Utah, or anywhere else.

18. Adequate quantities of materials, such as chemical limestone, clay or shale, and iron ore or slag, could have been purchased locally at established market prices, and blended together by mechanical methods,

and a resultant mineral mass obtained which could have been used to replace taxpayer's mineral in its cement processing; and for a short time in 1956 taxpayer did so when the transportation route from its quarry to its plant was flooded. However, it was taxpayer's actual experience that the processing costs of making cement from such materials was substantially greater than the costs of processing its own mineral.

19. During 1954, 1955 and 1956 the taxpayer purchased calcareous and siliceous minerals which it added to the mix made from its own cement rock for the purpose of "balancing the mix", so as to obtain the exact chemical composition required for the particular A. S. F. M. type of Portland Cement desired. Due to the physical characteristics of these materials which resulted in more difficult and costly grinding and sintering, none of taxpayer's profits were due or allocable directly to these purchased materials. These materials were merely ordinary costs incident to the production processes, similar to fuel, power, labor, supplies, etc.

20. The following amounts taken from taxpayer's books and records constitute satisfactory basis for the application of the government's formula for computing depletion:

Taxable year	1954	1955	1956
Gross income from mining:			
Quarrying stone, direct, indirect costs	$ 55,839.22	$ 53,994.30	$ 59,694.82
Primary crushing, direct, indirect costs	37,262.60	35,956.25	39,751.46
Freight on stone, direct, indirect costs	43,269.88	45,590.61	56,734.18
Secondary crushing, direct, indirect costs	82,374.65	83,010.59	86,211.39
Total Mining Costs	$218,746.35	$218,551.75	$242,391.85
Add proportionate profit on Mining:			
Total Cement Taxable income	331,863.38	253,604.52	312,224.76
Proportion which mining costs bear to total costs	22.8%	22.6%	23.8%

21. The application of the government's profit apportionment formula to the figures in finding No. 20, result in the following computations:

Taxable Year	1954	1955	1956
Profit allocable to mining	$ 75,664.85	$ 57,314.62	$ 74,309.49
Gross income from mining	294,411.20	275,866.37	316,701.34
Depletion rate	x 15%	x 15%	x 15%
Percentage depletion deduction	44,161.68	41,379.96	47,505.20

Taxable Year	1954	1955	1956
Limitation to 50% of taxable income from the property	37,832.43	28,657.31	37,154.75
Depletion previously allowed	15,797.24	None	24,472.66
Remainder of Depletion Allowance	22,035.19	28,657.31	12,682.09
Tax Rate	62%	52%	52%
		14,800.00	
Adjustment for Salary Disallowed ($5,400.00 x 52%)		2,808.00	
Refund due	11,458.30	11,992.80	6,594.69

From the foregoing Findings of Fact, the Court makes the following:

CONCLUSIONS OF LAW

1. Taxpayer's "mining" terminates after all crushing has been completed and the mineral product is ready to be introduced into grinding mills; and it is after all crushing has been completed that taxpayer's cement rock has reached the crushed rock stage.

2. The industry-wide practice in the cement industry, both as to processors using cement rock deposits and as to those using high calcium carbonate limestone and other materials, is to begin cement processing after all crushing has terminated and the material is reduced

to 3/4 inch or less in size for introduction into grinding mills.

3. The "proportionate costs" formula embodied in Treasury Regulations 118 Sec. 39.23(m)-1(e)(3), is an applicable method of determining the value of this taxpayer's mineral product at the crushed rock stage.

4. Plaintiff is entitled to a refund of taxes from defendant for 1954 in the sum of $11,458.30, for 1955 in the sum of $11,992.80, for 1956 in the sum of $6,-594.69, together with interest thereon at the rate of 6% per annum, as provided by law.

* * * *

WHEREFORE, based upon the Findings of Fact and Conclusions of Law hereinabove set forth, it is hereby Ordered that Judgment be, and the same is hereby granted and entered in favor of the plaintiff and against the defendant in the sums of $11,458.30 for 1954; $11,992.80 for 1955; and $6,594.69 for 1966, together with interest and costs as provided by law.

WILLIS W. RITTER
CHIEF JUDGE

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

NOVEMBER TERM, 1964

UNITED STATES OF AMERICA,
Appellant,

v.

PORTLAND CEMENT COMPANY OF UTAH,
a Utah corporation,
Appellee.

No. 7677

PORTLAND CEMENT COMPANY OF UTAH,
a Utah corporation,
Appellant,

v.

UNITED STATES OF AMERICA,
Appellee.

No. 7678

Appeals from the United States District Court
for the District of Utah, Central Division

Melva M. Graney (John B. Jones, Jr., Acting Assistant Attorney General, Lee A. Jackson, and Jonathon S. Cohen were with her on the brief) for Appellant in No. 7677 and Appellee in No. 7678.

Glen E. Fuller (Jack R. Decker was with him on the brief) for Appellee in No. 7677 and Appellant in No. 7678.

Before BREITENSTEIN, HILL and SETH, Circuit Judges.

BREITENSTEIN, Circuit Judge.

This income tax refund case is here for the third time.[1] The controversy concerns the depletion allowance to which Portland Cement Company of Utah, the taxpayer, is entitled because of its production of cement rock. The tax years in dispute are 1954, 1955, and 1956.

Taxpayer is an integrated miner-manufacturer. It mines cement rock at its own quarry in Parley's Canyon, Utah, and there crushes the rock to shipping size.[2] The rock is then transported 12 miles to taxpayer's crushing and is manufactured into cement. The trial court held that value for the purpose of the depletion allowance should be determined after the secondary crushing at the plant. The government contends that such value must be determined after the primary crushing at the quarry.

Percentage depletion allowances are governed by § 613 of the Internal Revenu Code of 1954. Subsection (a) provides that the allowance shall be a percentage of the "gross income from the property." Subsection (b) (6) authorizes a 15% allowance for various minerals including calcium carbonates. Cement rock is a calcium carbonate.[3] Subsection (c) (1) states that "gross income from the property" means, except for oil or gas, "gross income from mining." Before the amendment of 1960, 74 Stat. 290, 292, mining was defined by subsecton (c) (2) to include not only the extraction of the

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1 See United States v. Portland Cement Co. of Utah, 10 Cir., 293 F.2d 826, 315 F.2d 169.

2 The topography of the quarry site precludes other operations at that location.

3 Treas. Reg. 118, § 39.23(m)-5(b).

ores but also "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." The term "ordinary treatment processes" was defined by subsection (c)(4)(C) for minerals which are customarily sold in the form of a crude mineral product and included "sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment."[4]

In the first trial the district court held that the depletion allowance should be based on the value of the finished cement because that was the first commercially marketable product obtained from the cement rock deposit. Thereafter the Supreme Court decided United States v. Cannelton Sewer Pipe Co., 364 U.S. 76, which related to an integrated miner-manufacturer of burnt clay products. The Supreme Court held that the depletion allowance is "based on the constructive income from the raw mineral product, if marketable in that form, and not on the value of the finished article";[5] that the cut-off point for gross income from mining stops "where the ordinary miner shipped the product of his mine";[6] and that integrated mining-manufacturing operations must be "treated as if the operator were selling the mineral . . . to himself . . . "[7] On the author-

4 We are not concerned with subsection (c)(4)(F) which was added in 1960 and provides a pre-kiln cut-off point for cement producing minerals. Nor are we concerned with the Act of September 14, 1960, 74 Stat. 1017, 1018, which gave cement producers 60 days to elect that cut-off point for taxable years prior to 1961. See Riddell v. Monolith Portland Cement Co., 371 U.S. 537, 538, n. 1, rehearing denied 372 U.S. 932; and United States v. Monolith Portland Midwest Co., 9 Cir., 336 F.2d 402. Taxpayer did not elect to accept the pre-kiln cut-off point.

5 364 U.S. 76, at 86.

6 Id. at 87.

7 Id. at 89.

ity of Cannelton we reversed and remanded for a new trial.[8]

On the second trial the district court renewed its earlier holding that bulk cement was the first commercially marketable product and held additionally that the operations of the taxpayer included only processes normally applicable to obtain such product from the cement rock. Thereafter the Supreme Court decided Riddell v. Monolith Portland Cement Co., 371 U.S. 537, rehearing denied 372 U.S. 932, which related to an integrated cement miner-manufacturer. The Court said that the basis for depletion was "constructive income from crushed limestone, rather than from finished cement."[9] We reversed on the authority of Riddell and held that depletion is limited "to the constructive income from the limestone when it reached the crushed stage."[10]

We are concerned with two processes - primary crushing at the quarry and secondary crushing at the plant. The question is whether one or both are normally applied to obtain a commercially marketable product. The concept of a commercial marketability is based on sale of a product.[11] In our first opinion in this case we said that cement rock mined by the taxpayer "was not salable at the market at any stage of processing until it became finished cement." The government does not contend that cement rock is sold on the market.

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8 293 F.2d 826.
9 371 U.S. 537, at 539.
10 315 F.2d 169, at 171.
11 For example, in Riddell the Supreme Court pointed out that limestone was sold in large amounts in crushed form. See 371 U.S. 537, 539, n. 2.
12 293 F.2d 826, 828.

In Riddell the Supreme Court said that Cannelton held that in the case of an integrated miner-manufacturer the cut-off was "at the point where the mineral first became suitable for industrial use or consumption."[13] This rule was applied in United States v. Longhorn Portland Cement Co., 5 Cir., 328 F.2d 491, a cement rock case which differs from the instant case because there the cement plant was located at the quarry site. Longhorn is not helpful here because the issue it determined was whether "sintering" was an ordinary treatment process.

Taxpayer argues that suitability for industrial use occurs after all crushing, both primary and secondary. The government says that the cut-off point is determined by shippability. The close question presented has been answered by the Supreme Court. In Cannelton it held that gross income from mining stopped "where the ordinary miner shipped the product of his mine." [14] Riddell holds that mining terminates at the "crushed limestone stage."[15]

In our case the rock is shipped after primary crushing. A nonintegrated miner would have no occasion to perform the secondary crushing which is done by the taxpayer as a preparatory step in its manufacturing process. Indeed, the record shows that limestone of the sizes obtained by primary crushing sells for a higher price, because of ease in handling, than does limestone of the sizes obtained by secondary crushing. From the position of a miner selling his product opti-

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13 371 U.S. 537, 538.
14 364 U.S. 76, at 87.
15 371 U.S. 537, at 539.

mum marketability occurs after primary crushing because of the higher price.

The taxpayer points out that § 613(c)(2) defines mining to include limited transportation from the place of extraction to the plant "in which the ordinary treatment processes are applied." This argument brings us back to what is an ordinary treatment process. The applicable subsection (c)(4) definition of this term mentions several processes and includes "loading for shipment." In our case shipment occurs before secondary crushing.

We conclude that Cannelton and Riddell require the holding that mining terminates at the end of primary crushing. This means that the depletion allowance applies to the value of the product at that cut-off point.

The next question relates to the method of computing taxpayer's gross income from mining. In the absence of sales this must be determined constructively. The government contends, and the trial court held, that the proportionate profits formula embodied in the 1939 Treasury Regulations[16] is appropriate and applicable. Taxpayer says that the formula is not applicable and that the court erred in rejecting evidence showing its unfairness and the applicability of an alternative method which is claimed to reflect more appropriately taxpayer's gross income from mining.

The proportionate profits method is one under which profits from the product actually sold are allocated to mining according to the proportion of mining

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16 Treas. Reg. 118, § 39.23(m)-1(e)(3).

costs to total costs. The depletion allowance is then based on the allocation to mining.

Taxpayer attacks the formula on the ground that it prejudices the operator with low mining costs. The prejudice occurs because high mining costs, in relation to total costs, increase the percentage of profit attributable to mining and thus increase the depletion base. Taxpayer insists that its mining costs are low because of its extraordinary cement rock deposit.

Again we have a puzzling problem. Cannelton says that depletion is "an allowance for the exhaustion of capital assets" and is not a subsidy to "the high-cost mine operator."[17] Dissatisfaction with the 1939 formula is indicated by the proposed, but as yet unadopted, regulation under the 1954 Code which relates to the problem.[18] We are not impressed with the government's argument that Congress by the rejection of certain amendments to, and the subsequent passage of the Revenue Act of 1942[19] approved the proportionate profits method of computing the depletion base in a case such as the one before us. Those actions preceded the Cannelton decision. Cannelton approved the regulations only to the extent that they concerned the problem there presented.

The government also points out that the 1939 regulation provides that a method other than proportionate profits may be used if the taxpayer establishes to the satisfaction of the Commissioner that such different

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17 364 U.S. 76, at 86.
18 See Proposed Treas. Reg. § 1.613-3(b)(3)iii, 21 Fed. Reg. 8439, 8450 (1956).
19 56 Stat. 798.

method "clearly reflects the gross income from the property."[20] The argument is that no other method may be used without antecedent approval by the Commissioner. We are not so persuaded. Since this case started we have had two pertinent decisions by the Supreme Court and three appeals to the Court of Appeals. In the circumstances the courts should determine the proper method of arriving at constructive value.

The trial court's rejection of the evidence offered by the taxpayer precluded the taxpayer from presenting its contentions that the proportionate profits method is unfair and that another method more clearly reflects its gross income from mining. In our opinion the evidence should be received. On retrial the court should determine the validity of the proportionate profits method and, if it is held invalid, the method which should be applied to fix the depletion base.

The final question relates to the taxing of costs. After the second remand the government served notice under Rule 30(a), F.R.Civ.P., of the taking of a series of oral depositions in eastern states. The notice does not appear in the record. The taxpayer moved that the taking of the depositions be conditioned upon the assessment of its costs in connection therewith if it prevailed in the case. The trial court made no order on the motion. The depositions were taken; and, after judgment in its favor, the taxpayer moved to assess against the government the travel expense of its lawyers and consultants in attending the taking of the depositions and the expenses of obtaining copies of the depositions.

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20 Treas. Reg. 118 § 39.23(b)-1(e)(3).

The court gave judgment for $5,611.45 — the total claimed.[21]

Costs are imposed against the United States only to the extent permitted by law.[22] Because this case is brought under 28 U.S.C. § 1346(a) the applicable statute is 28 U.S.C. § 2412(b) which authorizes taxation against the United States of costs "actually incurred for witnesses and fees paid to the clerk." The presently contested items do not come within that authorization.

Taxpayer says that it is entitled to the costs under Rule 30(b) and relies on North Atl. & Gulf S.S. Co., Inc., v. United States, 2 Cir., 209 F.2d 487. That case did not arise under § 1346(a) and was decided on the basis of a local rule. Here we have no local rule and the taxpayer did not obtain a conditioning order before incuring the expenses which it seeks to tax as costs.[23] Its off-the-record explanation of why it did not obtain such order does not concern us. As we read Rule 30(b) the protective orders there mentioned must precede the taking of the depositions. In our opinion the deposition costs were improperly assessed against the United States.

The judgment is reversed in both No. 7677 and 7678 and the case is remanded for further proceedings in harmony with the views expressed in this opinion. Each party shall bear its own costs on these appeals.

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21 This included $44.00 for the trial attendance of one witness. We express no opinion on the propriety of this item.

22 Rule 54(d), F.R.Civ.P.; 28 U.S.C. § 2412(a). See also Reconstruction Fin. Corp. v. J. G. Menihan Corp., 312 U.S. 81, 83; United States v. Worley, 281 U.S. 339 344; and United States v. Chemical Foundation, 272 U.S. 1, 20.

23 Cf. Euler v. Weller, 10 Cir., 295 F.2d 765, 767.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

PORTLAND CEMENT COMPANY OF UTAH,
a Utah corporation,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

C 12-60

FINDINGS OF FACT CONCLUSIONS OF LAW AND JUDGMENT

The above-entitled cause having come on regularly for trial on the 6th day of January, 1966, Glen E. Fuller and Jack R. Decker, attorneys, appearing for and on behalf of the plaintiff, and William T. Thurman, U. S. Attorney, and Thomas F. Field of the Tax Division, U. S. Department of Justice, Washington, D.C., appearing for and on behalf of the defendant; and evidence, both oral and documentary, having been introduced and received by the court, and the court having requested the parties to submit written briefs on the applicable law and facts, and having thereafter considered the same and having announced its ruling and decision, and having requested that counsel for plaintiff prepare appropriate fiindings of fact and conclusions of law, and a judgment, now makes the following:

FINDINGS OF FACT

1. Jurisdiction in this matter is conferred upon the court by Section 1346, Title 28, United States Code Annotated.

2. The former Portland Cement Company of Utah, a Wyoming corporation, was engaged in the mining of cement rock from its own quarry and the processing therefrom of cement, during the years 1954, 1955 and 1956; and in 1958, said corporation merged with the Snow-Pym Corporation, a Utah corporation, forming the plaintiff Portland Cement Company of Utah, a Utah corporation, under and by reason of which merger plaintiff succeeded to and acquired all the rights of action of Portland Cement Company of Utah, a Wyoming corporation.

3. Plaintiff's cement plant now is, and was during the years 1954, 1955 and 1956, located at Eighth South Street and Fifth West Street in SaltLake City, Utah; and said company had its offices at 24 East Fourth South Street, Salt Lake City, Utah. Its quarry was at such time, and still is, located twelve miles east of the cement plant in Parley's Canyon.

4. During each and all of said years, plaintiff was, and now is, engaged solely in the mining of an argillaceous limestone with constituents of ideal chemical and physical proportion and combination for cement manufacture, and in the processing of this rock into finished cement. The mineral is known in the trade as "cement rock", and plaintiff's deposit has value for no other purpose.

5. In processing said cement rock into finished cement, plaintiff first blasted the rock out of a mountainous quarry face, and further reduced the rock by secondary blasting of large boulders which were obtained; the rock was then crushed in a gyratory crusher to sizes of two to four inches rough diameter plus "fines" ranging in size down to splinters. The crushed material was then transported to the plant in Salt Lake City where the rock was further crushed to three-fourth inch rough diameter size. The rock was then ground in ball mills to a fineness of 90% in volume passing through a 200 mesh sieve, and water was added to the ball mills, forming a "slurry", which is a very fine mud. The slurry was placed in tanks where it was mixed and made uniform, and after such mixing it fed into rotary kilns where it was sintered. The resulting clinker was cooled and later ground into cement, which was stored in silos for future sale. In the final mixing tank, it was customary to add on occasions either high lime mixture or high silica mixture in order to balance the chemical composition of the slurry in order to maintain uniformity of product; and gypsum was added to the clinker prior to grinding in order to retard the set of concrete which would subsequently be made from the cement.

6. The treatment processes applied by plaintiff taxpayer were and are the ordinary treatment processes normally applied by cement rock miners or operators throughout the Unietd States and in the production of cement.

7. The average chemical analysis of plaintiff's cement rock, determined by the oxide basis of analysis

was about 42% Ca O, 18% Si O^2, 2% to 3% Al^2 O^3, 2% to 3% Fe^2 O^3, trace elements of the alkalies, plutonium and manganese, and small amounts of magnesium carbonate.

8. Plaintiff has never sold any of the cement rock it produced, nor made any other use of it than to make cement. Fines produced at the quarry have had to be hauled away at plaintiff's expense for lack of any market; and when a highway was cut through plaintiff's deposit, the road builders did not use the cement rock, but rather hauled in other materials.

9. There is not a product which plaintiff produced, or which it might have produced, from its cement rock deposit which was or is marketable prior to the production of bulk cement. Cement rock, as defined in the trade and scientific books and works of general reference is not suitable for any purpose other than processing into cement, there being an abundance of other suitable materials in all parts of the nation for all other industrial uses. In fact, there is no market at all for cement rock in any form in the general area of the taxpayer, in any of the surrounding states, or anywhere in the entire United States prior to its sale as bulk cement.

The bulk cement sold by the plaintiff was at all times the first and only commercially marketable product obtainable from its cement rock deposit. Cement is the first and only commercially marketable product obtainable from any cement rock mined anywhere in the United States.

10. Plaintiff filed with defendant, within the time allowed by law, claims for refund of the amounts of tax paid as a result of the lower depletion allowance permitted by defendant, and on January 20, 1960, plaintiff received notice that the said claims for refund were refused. This action was brought more than six months subsequent to the filing of said claims for refund.

This matter was remanded to this court for a determination of the constructive gross income from mining after its mineral had completed the primary crushing process, thereby requiring that additional evidence be taken to ascertain the depletion base and depletion allowance.

11. The taxpayer's mineral deposit is of a very rare type which is, and was, in the years under dispute, more valuable and more desirable for the purpose of use as a raw material in cement processing than Monolith's California deposit, or local deposits of chemical limestone such as that sold to taxpayer by Utah Lime and Stone Co. or deposits in other areas of limestone used as a raw material in cement processing.

12. "Cement rock" is, and has been since 1908, recognized in the Minerals Yearbook officially published by the United States Department of Interior, as a mineral distinct from other types of limestone which may be used, together with other necessary minerals, in the processing of cement.

13. No mineral of the like kind and grade to taxpayer's has ever been sold locally, in the State of Utah, or anywhere else.

14. The evidence has affirmatively established and the Court so finds that no single deposit has been discovered within a 75 mile radius of plaintiff's plant in Salt Lake City from which cement can be made meeting A. S. T. M. specifications and customer color requirements, except the one being mined by Ideal Cement Company at Devils Slide, Utah.

15. Adequate quantites of materials, such as chemical limestone, clay or shale, and iron ore or slag, could have been purchased locally at established market prices, and blended together by mechanical methods, and a resultant mineral mass obtained which could have been used to replace taxpayer's mineral in its cement processing; and for a short time in 1956 taxpayer did so when the transportation route from its quarry to its plant was flooded. However, it was taxpayer's actual experience that the processing costs of making cement from such materials was substantially greater than the costs of processing its own mineral.

16. During 1954, 1955 and 1956 the taxpayer purchased calcareous and siliceous materials which it added to the mix made from its own cement rock for the purpose of "balancing the mix", so as to obtain the exact chemical composition required for the particular A.T.S.M. type of Portland Cement desired. Due to the physical characteristics of these materials, which resulted in more difficult and costly grinding and sintering, none of taxpayer's profits were due or allowable directly to these purchased materials. These materials were merely similar to fuel, power, labor, supplies, etc.

17. The evidence has established and this Court so finds, that plaintiff's mineral product has a value of $3.70 per ton after primary crushing. This figure has been based upon established prices in the Salt Lake City market area of a group of materials which were available in sufficient quantity and which could have been blended together to produce a mix to substitute for plaintiff's cement rock. This figure includes transportation costs of the substitute materials from the mines to the taxpayer's plant, less the taxpayer's cost of transporting its own rock from its quarry to its plant.

18. The taxpayer's substitute materials method of computing the value of its mineral product at the cut-off point has reduced dependence on estimates to a bare minimum, and the Court finds that this method more accurately and fairly reflects the value at the crushed rock stage than any other method that has been suggested to this Court. The Court further finds that this method conforms to good accounting practice and to the proposed (but as yet unadopted) Treasury Regulation Par. 1.613-3(b) (4) (i), which is a modification of the representative field price method, suitable to the computation of a "constructive" gross income from mining.

19. The "proportionate profits" formula advanced by the government multiples the ratio of *book* dollar costs of mining (through primary crushing) to total *book* dollar costs, times the gross receipts from the sale of cement (adjusted for bagging costs) to determine the value of the taxpayer's mineral product after

primary crushing. This taxpayer's *book* costs of mining and processing bear no necessary relationship to the *value* of its mineral depleted, and the ratio of *book* costs does not reflect in the slightest degree the *value of this taxpayer's mineral.* The application of this ratio to gross receipts gives a result which does not reflect the value of this taxpayer's cement rock after primary crushing. The government formula apportions the book net profit equally among the dollars of cost as though earned by them, without attributing one cent of gross receipts to the cement rock depleted and used.

This Court finds that government's "proportionate profits" formula is a totally unsatisfactory method of determining this taxpayer's "constructive income from mining", and it results in a "depletion allowance" grossly inadequate to permit the tax-free recovery of the capital value of this taxpayer's mineral used and depleted.

20. This Court finds that the depletion and refund computation required and supported by the facts of this case are as follows:

DEPLETION COMPUTATION

	1954	1955	1956
Tonnage produced by Company	69,300	73,140	85,869
Value per ton	3.70	3.70	3.70
Value of Tonnage Produced	$256,410.00	$270,618.00	$317,715.30
Depletion rate	15%	15%	15%
Depletion Allowance in Dollars	$38,461.50	$40,592.70	$47,657.30
Depletion previously allowed	$15,797.24	None	$24,472.66
Remainder of Depletion Allowance	$22,664.26	$40,592.70	$23,184.64
Tax Rate	52%	52%	52%
		$21,108.20	
Adjustment for Salary Disallowed		$ 2,808.00	
Refund due	$11,785.42	$18,300.20	$12,056.01
			$42,141.63

From the foregoing Findings of Fact, the Court makes the following:

CONCLUSIONS OF LAW

1. The "proportionate costs" formula embodied in Treasury Regulations 118 Sec. 39.23(m)-1(e)(3), is not an applicable method of determining the value of this taxpayer's product at the crushed rock stage.

2. The taxpayer's substitute materials method of computing the value of its mineral product at the cut-

off point more accurately and fairly reffects that value than any other method, and is a proper and staisfactory method of computing this taxpayer's "constructive gross income from mining."

3. Plaintiff is entitled to a refund of taxes from defendant for 1954 in the sum of $11,785.42, for 1955 in the sum of $18,300.20 for 1956 in the sum of $12,-056.01, together with interest therein at the rate of 6% per annum, as provided by law.

Wherefore, based upon the Findings of Fact and Conclusions of Law hereinabove separately set forth, it is hereby Ordered that Judgment be, and the same is hereby granted and entered in favor of the plaintiff and against the defendant in the sums of $11,785.42 for 1954; $18,300.20 for 1955; and $12,056.01 for 1956, together with interest as provided by law.

April 29, 1966.

/s/ WILLIS W. RITTER
Willis W. Ritter
Chief Judge

Entered 4-29-66

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

v.

PORTLAND CEMENT COMPANY OF UTAH,

Appellee.

Appeal from the United States District Court
for the District of Utah
Central Division

No. 8886 - March Term, 1967

Robert Livingston (Mitchell Rogovin, Assistant Attorney General, Lee A. Jackson, and Melva M. Graney, Attorneys, Department of Justice, were with him on the brief), for Appellant.

Glen E. Fuller (Jack R. Decker was with him on the brief) for Appellee.

Before LEWIS, BREITENSTEIN and HICKEY, Circuit Judges.

BREITENSTEIN, Circuit Judge.

We have again the problem of how to determine, for the purpose of fixing the depletion allowance granted by federal income tax statutes, the income from the mining of a unique mineral for which no market exists and which is first salable commercially as a finished

product, cement. In the absence of sales of the mineral the gross income from mining must be determined constructively. The question is how to do this. The trial court adopted the substitute-materials method of the taxpayer and rejected the proportionate-profits method of the government. We must decide between the two.

The dispute concerns the taxpayer's claims to tax refunds for the years 1954, 1955, and 1956. It is before us for the fourth time.[1] The taxpayer, an integrated miner-manufacturer, mines cement rock at its own quarry in Parley's Canyon, Utah. The cement rock is put through the primary crushing stage at the quarry. It is then hauled 12-13 miles to the taxpayer's plant in Salt Lake City where it is crushed further and made into cement. In our first opinion, we disapproved the claim that the depletion could be based on the finished product.[2] In our second opinion we held that depletion is limited "to the constructive income from the limestone when it reached the crushed stage."[3] Our third decision was that mining ended with primary crushing and that the income from mining must be determined at that point.[4] We remanded the case for determination of "the validity of the proportionate profits method and, if it is held invalid, the method which should be applied to fix the depletion base."[5]

The trial court took evidence bearing on the applicability and effect of the two proposed methods in arriving at taxpayer's constructive income from min-

1 See United States v. Portland Cement Company of Utah, 10 Utah, 10 Cir., 293 F.2d 826, 315 F.2d 169, and 338 F.2d 798.
2 293 F.2d 826, 830.
3 315 F.2d 169, 171.
4 338 F.2d 798, 802.
5 Id. at 803.

ing. It held that the substitute-materials method "more accurately and fairly reflects the value at the crushed rock stage than any other method that has been suggested to this Court." On this basis, the court fixed the value per ton for each year at $3.70 and, to arrive at the depletion base, multiplied the annual tonnage by this figure. The 15% depletion allowance was applied to the sums so determined. This resulted in findings and judgment that refunds of $11,785, $18,300, and $12,056 were due for the years 1954, 1955, and 1956 respectively. No findings were made as to the income from mining under the proportionate-profits method.[6]

Section 611(a) of the Internal Revenue Code of 1954, 26 U.S.C. § 611(a), allows a deduction from taxable income of depletion of natural deposits "according to the peculiar conditions in each case." We are concerned with calcium carbonate for which § 613 (b)(6) allowes a depletion of 15% of the "gross income from the property." The Treasury Regulations[7]

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6 It would be substantially less. Government exhibits fixed the gross income from mining for the three years at $130,897, $117,705, and $129,970. The court found the "value of tonnage produced" to be $256,410, $270,618, and $317,715 respectively.

7 Treas. Reg. 118 § 39.23(m)-1(e)(3) (1939 Code) says, so far as pertinent, that "gross income from the property" means: "If there is no such representative market or field price (as of the date of sale) then there shall be used in lieu thereof thee representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method." In our third decision, 338 F.2d 798 802-803, we rejected the argument that antecedent

implementing the statute have long prescribed methods of making a constructive computation of gross income from mining. The first is the use of representative market price; but here it is conclusively established that there was no such price. Under the second, or proportionate-profits method, the sale price of the product actually sold by the taxpayer (here, the sale price of cement) is allocated to mining according to the ratio that the costs of mining (here, the costs up through primary crushing) bear to total costs (here, the cost of cement). This method assumes that each cost produces a proportionate part of the profit.

The taxpayer's substitute-materials method requires more explanation. Portland cement is made of a mixture of calcium carbonate, aluminum silicate, other silicates, and iron. Cement rock is a rare material which contains within itself all the necessary constituents of a cement "mix" in approximately the correct proportons and without excessive impurities.[8] Cement rock has no use other than for making portland cement. The taxpayer's evidence established the prices in the Salt Lake City area of a group of available materials "which could have been blended together to produce a mix to substitute for the cement rock." The figures included the transportation costs "less the taxpayer's cost of transporting its own rock from its quarry to its plant." The substitute-materials method is based

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approval of the Commissioner was required as a condition precedent to the use of a method other than proportionate-profits because of the unusual circumstances surrounding this case.

8 In the use of cement rock some variations of the mix are needed to meet the specifications peculiar to different types of cement.

on the hypothesis that the taxpayer might have reconstructed the material in its cement rock by paying for the delivery to its plant, and use, of each component of cement rock. This amounts to the replacement of the cement rock by the components thereof and is in effect a reconstruction cost. The trial court adopted the theory of the taxpayer and found that its mineral product "has a value of $3.70 per ton after primary crushing." Thus, the trial court arrived at a theoretical value of the product mined rather than the gross income from mining.

In Anderson v. Helvering, 310 U.S. 404, 408, the Supreme Court said that a deduction for depletion is "permitted as an act of grace and is intended as compensation for the capital assets consumed in the production of income through the severance of the minerals." The statute says, § 611(a), that a "reasonable allowance" shall be made "according to the peculiar conditions in each case * * * under regulations prescribed by the Secretary * * *." The decision in Douglas v. Commissioner of Internal Revenue, 322 U.S. 275, 281, points out that because Congress "obviously could not foresee the multifarious circumstances which would involve questions of depletion, it delegated to the Commissioner the duty of making the regulations." Here we are concerned with a regulation of more than 25 years standing.[9] It has been before the courts a

9 In our third decision in this case, 338 F.2d 798, 892, fn. 18, we mentioned Proposed Treas. Reg. § 1.613-3(b)(3)iii, 21 Fed. Reg. 8439, 8450, (1956). This was subsequently withdrawn. The presently proposed regulation, Proposed Treas. Reg. § 1.613-3(d), 31 Fed. Reg. 9508, is substantially similar to the regulation set out in footnote 7 supra. It provides for the proportionate-profits method and contains no authorization for anything resembling the taxpayer's substitute-materials method.

number of times[10] without question of its underlying validity being raised. The taxpayer has the burden of showing both that the proportionate-profits method of the regulations is unreasonable and that its substitute-materials method is reasonable.

The briefs of the parties dwell at length on the mysteries of accounting. We prefer to direct our attention to the statute. Section 613(a) says that "the allowance for depletion * * * shall be the percentage [here 15%] * * * of the gross income from the property * * * ." The controlling factor is gross income.[11]

The taxpayer attacks the proportionate-profits method on several grounds. It rightly asserts that such method proceeds on the premise that each dollar of cost produces a proportionate amount of profit. Eminent accounants are quoted to establish the fallacy of such reasoning. The government counters with statements of other writers on accounting. Our view is that all costs have to be recovered before there is a profit. If the inclusion of unproductive costs so distorts the equation that the application of the formula does not in fact clearly reflect the gross income from the property, they may be excluded. In the case at bar the taxpayer makes no showing of unproductive costs.

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10 See Standard Lime and Cement Co. v. United States, Ct. Cl., 329 F.2d 939; Riddell v. Monolith Cement Co., 371 U.S. 537; Whitehall Cement Manufacturing Co. v. United States, 3 Cir., 369 F.2d 468.

11 We realize that in United States v. Cannelton Sewer Pipe Co., 364 U.S. 76, 86, and in our third decision in this case, 338 F.2d 798, 802, reference is made to "value" of the product. This loose use of the term "value" cannot change the statute. Additionally the Court said in Cannelton, 364 U.S. 76, 86, that the legislative history shows that "Congress intended to grant miners a depletion allowance based on the constructive income from the raw mineral product * * * ."

We will agree with the taxpayer that the government method may penalze the low-cost miner because hight mining costs, in relation to total costs, increase the percentage of profit attributable to mining and thus increase the depletion base. In brief and argument the taxpayer asserts that it is a low-cost operator and, hence, prejudiced by the formula. The difficulty is that the record contains no proof to this effect.[12] The taxpayer has failed to convince us that it is a low-cost operator which is penalized for that reason by the proportionate-profits method.

Another objection to the government formula is that it uses book costs to arrive at value. Certainly such costs represent and record real expenditures. They are taken from the taxpayer's ledgers. No showing is made of any instance in which they might be incorrect. The government does not try to "value" the product on the basis of book costs. Rather, it seeks to arrive at a constructive income from mining by using the taxpayer's records.

Although the depletion allowance is intended to compensate for the loss of a capital asset,[13] that allowance "bears little relationship to the capital investment, and the taxpayer is not limited to a recoupment of his original investment."[14] The argument that the propor-

12 There is evidence that the use of taxpayer's product results in a reduced sintering cost. This is immaterial for two reasons. First, sintering occurs after the cut-off point for fixing the depletion base. Second, reduction in processing costs creates a higher percentage for mining costs and, hence, a higher depletion base. It should be noted that the taxpayer did not elect to accept the pre-kiln cut-off point permitted by a 1960 statute. See 338 F.2d 798, 800, fn. 4.

13 See Kirby Petroleum Co. v. Commissioner of Internal Revenue 326 U.S. 599, 602-603.

14 Commissioner of Internal Revenue v. Southwest Exploration Co., 350 U.S. 308, 312.

tionate-profits method is unfair because it does not take into account the value of the deposit was rejected in Whitehall Cement Manufacturing Co. v. United States, 3 Cir. 369 F.2d 468, 472-473.[15] We also reject this argument. The value of a deposit is not the measure of income therefrom.

The taxpayer insists that the peculiar conditions of its operation make the substitute-materials method a reasonable procedure for the establishment of the depletion base. The replacement of the function of cement rock by the use of substitute materials from which cement can be made furnishes a basis for determining the value of cement rock. The value of a product is not necessarily the same as the gross income from the production of that product. For there to be income the product must be converted to money or its equivalent. A synthetic determination of the aggregate value of the components of cement rock is not the equivalent to the gross income received from the mining of that rock.

The trial court in its findings on the depletion computation does not characterize as income from mining the amount arrived at by multiplying the tonnage and the value per ton established by the substitute-materials method. Instead it finds an amount described

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15 Although the Whitehall case related to cement rock, it is not analogous to the situation before us. In Whitehall, the taxpayer elected to accept the pre-kiln cut-off point. Here the taxpayer did not so elect. In Whitehall, the taxpayer's alternative to the proportionate-profits method was a formula whereby the gross income from cement was determined on the ratio of the weight of cement rock to the weight of all other ingredients. The gross income from mining was reached by application of the ratio of pre-kiln costs with total direct costs to the gross income from cement rock. Whitehall did not consider the substitute-materials method.

as "Value of Tonnage Produced" and applies the depletion percentage thereto. In our opinion, the statute does not permit such procedure. We decline to equate value of product with gross income from mining in the circumstances here presented.

It may be that in some situations a constructive determination of gross income can be made by the use of substitute-materials method. All we now say is that on the record presented and the peculiar conditions here pertaining, the proportionate-profits method results in a reasonable depletion allowance and that the substitute-materials method does not reflect the gross income from the property.

The judgment is reversed and the case is remanded for determination of the refunds, if any, to which the taxpayer is entitled in accordance with the views expressed in this opinion.

AMENDMENT V — CAPITAL CRIMES; DOUBLE JEOPARDY; SELF - INCRIMINATION; DUE PROCESS; JUST COMPENSATION FOR PROPERTY.

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Internal Revenue Code of 1954:

SEC. 611. ALLOWANCE OF DEDUCTION FOR DEPLETION.

(a) *General Rule.*—In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate. For purposes of this part, the term "mines" includes deposits of waste or residue, the extraction of ores or minerals from which is treated as mining under section 613(c). In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or

less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this section for subsequent taxable years shall be based on such revised estimate.

Internal Revenue Code of 1954:

SEC. 613. PERCENTAGE DEPLETION.

(a) *General Rule.*—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b) of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion). In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section.

(b) *Percentage Depletion Rates.* — The mines, wells, and other natural deposits, and the percentages, referred to in subsection (a) are as follows:

* * * * *

(6) 15 percent—all other minerals (including; but not limited to, aplite, barite, borax, calcium carbonates, refractory and fire clay, diatomaceous earth, dolomite, feldspar, fullers earth, garnet, gilsonite, granite, limestone, magnesite magnesium carbonates, marble phos-

phate rock, potash, quartzite, slate, soapstone, stone (used or sold for use by the mine owner or operator as dimension stone or ornamental stone), thenardite, tripoli, trona, and (if paragraph (2) (B) does not apply) bauxite, beryl, flake graphite, fluorspar, lepidolite, mica, spodumene, and talc, including pyrophyllite), except that, unless sold on bid in direct competition with a bona fide bid to sell a mineral listed in paragraph (3), the percentage shall be 5 percent for any such other mineral when used, or sold for use, by the mine owner or operator as rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes. For purposes of this paragraph, the term "all other minerals" does not include—

(A) soil, sod, turf, water, or mosses; or

(B) minerals from sea water, the air, or similar inexhaustible sources.

(c) *Definition of Gross Income from Property.*—For puruposes of this section—

(1) *Gross income from the property.*—The term "gross income from the property" means, in the case of a property other than an oil or gas well, the gross income from mining.

(2) Mining.—The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the

point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

(3) *Extraction of the ores or minerals from the* ground.—The term "extraction of the ores or minerals from the ground" includes the extraction by mine owners or operators of ores or minerals from the waste or residue of prior mining. The preceding sentence shall not apply to any such extraction of the mineral or ore by a purchaser of such waste or residue or of the rights to extract ores or minerals therefrom.

(4) Ordinary treatment processes. — The term "ordinary treatment processes" includes the following:

(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

(B) in the case of sulfur recovered by the Frasch process—pumping to [illegible]oling, breaking, and loading for shipment;

(C) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentraing, and sintering to bring to shipping grade and form, and loading for shipment;

(D) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not cus-

tomarily sold in the form of the crude mineral product —crushing, grinding, and benefication by concentration (gravity flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores; and

(E) the pulverization of talc, the burning of magnesite, and the sintering and nodulizing of phosphate rock.

(26 U.S.C. 1958 ed., Sec. 613).

Treasury Regulatons 118 (1939 Code):*

Sec. 39.23(m)-1. *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*— * * *

* * * * *

(e) As used in sections 114(b)(3) and 114 (b (4 (A and ‡§39.23(m)-1 to 39.23(m)-19, inclusive, the term "gross income from the property" means the following:

* * * * *

(3) If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine" gross income from the property" means the

*On this subject, there are no final Regulations promulgated under the Internal Revenue Code of 1954. For proposed Regulations, see 21 Fed. Register, part 8, pp. 8439, 8488,8452 (November 3, 1956).

amount for which such product was sold, but if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from the property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transporation of such product (other than transportation treated, for the taxable year as mining). If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.